Supreme Court, U.S.
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No. 09- OFFICE OF THE CLERK

In the

Supreme Court of the United States

THOMAS W. HEATH, III,

Petitioner,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether, on a petition to review the affirmance by the Securities and Exchange Commission ("Commission" or "SEC") of a finding by NYSE Regulation, Inc. ("NYSE") that a member violated NYSE's catch-all "just and equitable" disciplinary rule, a court of appeals must determine as a fundamental norm of administrative law whether the NYSE and the Commission articulated and then applied an "ascertainably certain" standard for the rule specific enough to provide fair notice of the conduct that could result in such a finding (as required by precedents of the D.C. Circuit that the court below did not follow)?

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PETITION FOR A WRIT OF CERTIORARI

Thomas W. Heath, III respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Second Circuit.

OPINIONS BELOW

The opinion of the court of appeals dated November 4, 2009 (App., *infra*, App. 1-51) is reported at 586 F.3d 122. The SEC's opinion dated January 9, 2009 appears at App. 52-87. The October 17, 2007 decision of the NYSE Board of Directors appears at App. 88-89, the March 15, 2007 decision of the NYSE Hearing Board appears at App. 90-104, and the November 24, 2006 Order of the NYSE Chief Hearing Officer appears at App. 104-22.

JURISDICTION

The judgment of the court of appeals was issued on November 4, 2009. App. 1. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

RULE INVOLVED

NYSE Rule 476(a)(6), which was adopted by the NYSE with the approval of the Commission pursuant to 15 U.S.C. § 78f(b)(6), reads as follows:

> (a) If a member, member organization, allied member, approved person, registered or non-registered employee of a member or member organization or person otherwise subject to

the jurisdiction of the Exchange is adjudged guilty in a proceeding under this Rule of any of the following offenses . . .

(6) conduct or proceeding inconsistent with just and equitable principles of trade; . . . then, in any such event, the Hearing Panel or, when authorized by this Rule, a Hearing Officer shall, in accordance with the procedures set forth in this Rule, impose one or more of the following disciplinary sanctions on such member, member organization, allied member, approved person, or registered or non-registered employee or person otherwise subject to the jurisdiction of the Exchange: expulsion; suspension; limitation as to activities, functions, and operations, including the suspension or cancellation of a registration in, or assignment of, one or more stocks; fine; censure; suspension or bar from being associated with any member or member organization; or any other fitting sanction.

STATEMENT

This case presents an opportunity for the Court to address conflicting decisions of the circuits regarding the requisite enforcement standards for the catch-all rule allowing discipline of NYSE members for conduct inconsistent with "just and equitable principles of trade." NYSE Rule 476(a)(6) ("J&E Rule"); *see*

also 15 U.S.C. § 78f(b)(5) (2006) (authorizing Rule).[1] The underlying issue is one of fundamental importance: what fair notice must be given to regulated members to enable a federal agency such as the SEC to enforce disciplinary rules of conduct.

The court below held that the J&E Rule does not require an enforcing agency to prove a particular mental state or that a regulated member acted in "bad faith," but only that he or she simply engaged in undefined "unethical conduct." App. 41. By contrast, the D.C. Circuit requires an "ascertainably certain" standard for disciplinable conduct before sustaining enforcement. *See Marrie v. SEC*, 374 F.3d 1196, 1206 (D.C. Cir. 2004); *Checkosky v. SEC*, 139 F.3d 221, 225 (D.C. Cir. 1998) ("*Checkosky II*"). At this juncture in our nation's economic history, when an increase in FINRA disciplinary proceedings would appear likely, the absence of an ascertainably certain standard for the J&E Rule will permit an ad hoc approach to disciplinary actions, thereby unfairly disrupting the careers of many members and constricting the effectiveness of judicial review. This is the right time and the right case to address the important question presented.

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[1] The substance of NYSE Rule 476(a)(6) is now found in Rule 2010 of the NYSE and also of the Financial Industry Regulatory Authority ("FINRA"), which exercises the regulatory functions previously exercised by the NYSE. *See* FINRA Rule 2010 ("A member, in the conduct of its business, shall observe high standards of commercial honor and just and equitable principles of trade.").

1. Heath joined J.P. Morgan Securities ("Morgan") as an investment banker in 1992. In early 2005, Heath was working to secure Morgan's engagement as financial advisor to Hibernia Bank ("Hibernia") in connection with its proposed merger with Capital One Corp. ("CapOne"). App. 4-5.

At the same time, Bank of America Securities ("BofA") asked Heath to join BofA at a higher position and for greater compensation than Heath had at Morgan, and Heath gave a verbal commitment to join BofA. Heath was asked to begin at BofA in one week, but Heath committed to stay at Morgan to secure the Hibernia engagement and to get the merger agreement signed (even though Heath would forfeit any deal-based bonus by moving to BofA). App. 5-6.

BofA began transitioning Heath to BofA while Heath remained at Morgan and asked Heath, in particular, to get to know Eric Corrigan, who would be reporting to Heath in a few days. Heath and Corrigan spoke by phone on March 1, and near the end of this 41-minute call Corrigan pressed Heath about the deal Heath was then working on for Morgan; Corrigan pledged to keep the information confidential, which Heath believed. App. 99. Heath made a split-second decision and shared information about the deal with Corrigan. App. 99-100.

But Corrigan breached his pledge of confidentiality by telling a BofA colleague, Thomas Chen, about the deal. Chen, in turn, placed a call to a contact at CapOne – already a BofA client – trying to

see if CapOne would retain BofA as an advisor on the Hibernia deal. Chen left a voicemail, which was not returned. However, BofA learned of the call by Chen to CapOne and – after an internal investigation – terminated Corrigan and Chen. As a direct result of this incident, Heath lost his job at Morgan, lost his job at BofA, and remained out of work for two years. App. 9-11.

2. The NYSE Division of Enforcement ("Enforcement") initiated disciplinary proceedings against Heath (but not Corrigan or Chen) alleging a violation of Rule 476(a)(6). The NYSE's Chief Hearing Officer granted Enforcement's summary judgment motion determining Heath to be guilty without any evidentiary hearing. App. 104-22. The Chief Hearing Officer rejected Heath's argument that Enforcement was required to prove that he acted in "bad faith" and held instead that Enforcement only needed to show that Heath engaged in "unethical conduct," a term that the Officer did not define. A full Hearing Panel convened to hear evidence and argument regarding the penalty found that Heath "lacked any bad faith," that he was right in thinking that nothing about the deal was going to change "given the advanced stage of the negotiations . . . at the time of the disclosure," that there was "no actual harm in the case before us," and that "the risk of harm . . . was small." App. 96, App. 99. The Panel also found that Heath's disclosure was made without premeditation, was a "momentary lapse in judgment," was not motivated by goals of personal enrichment, and stemmed from a single indiscretion that was unlikely to be

repeated, against a backdrop of an otherwise unblemished career. App. 99-100. In the end, the Panel incorporated the Chief Hearing Officer's summary judgment order and imposed on Heath a fine of $100,000 and a censure.

3. Heath sought review of the determination of guilty only (and not the sanction) before the NYSE Board of Directors, which affirmed the Hearing Panel's decision. Heath then appealed to the Commission, which rejected Heath's argument that – because he did not act in bad faith – he had not violated the J&E Rule. The Commission also rejected Heath's argument that he lacked fair notice that he could be disciplined for actions not taken in bad faith. App. 78.

4. Heath petitioned for review of the SEC's decision in the Second Circuit, which denied the petition in a 39-page published opinion. The court held that, in a case involving a breach of confidence (but not one involving a breach of contract), the SEC may discipline "mere unethical conduct" without a showing of bad faith, App. 41; the court further held that the agency could impose discipline for an undefined set of unethical actions that are "'technically outside the area of definite illegality.'" App. 24 (citation omitted). The court rejected Heath's argument that neither the NYSE nor the Commission had provided fair notice to regulated parties of the requisite mental state for a J&E Rule violation. App. 47.

REASONS FOR GRANTING THE WRIT

In Conflict with D.C. Circuit Precedents, the Second Circuit Did Not Require the Commission To Articulate and Apply an "Ascertainably Certain" Standard for the Catch-All J&E Rule

The decision below conflicts with precedents of the D.C. Circuit requiring SEC disciplinary rules to be "ascertainably certain" and to provide "with some degree of specificity" the standard against which the member's conduct is judged. *Checkosky II*, 139 F.3d at 224. Without such a standard, an agency comes "close to a self-proclaimed license to charge and prove improper professional conduct whenever it pleases." *Id.* at 225. In the view of the D.C. Circuit, there is "no justification for the government depriving citizens of the opportunity to practice their profession without revealing the standard they have been found to violate." *Id.* at 225-26. In contrast, the court below affirmed the finding that Heath violated the catch-all J&E Rule by engaging in undefined "unethical conduct" unmotivated by bad faith based solely on a single unpremeditated disclosure of confidential client information to a soon-to-be colleague who had pledged confidentiality.

The different approaches of the Second and D.C. Circuits are reflected in at least three critical ways. First, the D.C. Circuit has focused on the context of an administrative proceeding and has stated that "fair notice of the standards against which one is to be judged is a fundamental norm of administrative

law." *Marrie*, 374 F.3d at 1206.[2] In contrast, the court below applied a Constitutional vagueness analysis untethered to the administrative context. *See* App. 44-47.[3] Second, the D.C. Circuit has insisted that an agency articulate and apply an "ascertainably certain" standard, including a mental state; the court below did not do so, employing instead a reasonable person test in concluding what Heath should have known. Third, in effectively rewriting the Commission's opinion in this case, the Second Circuit stated (with no citation to any opinion of this Court) that "some level of deference" was due to the NYSE and the SEC's interpretation of the NYSE rules, *see* App. 41, even though, as the court's

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[2] *See also Gen. Elec. Co. v. U.S. Envtl. Prot. Agency*, 53 F.3d 1324, 1329 (D.C. Cir. 1995) (holding that the requirement that an agency provide fair notice "has now been thoroughly 'incorporated into administrative law'" – the "principle is not constitutional, but 'basic hornbook law in the administrative context'" (citation omitted)); *Checkosky II* at 224 ("[e]lementary administrative law norms of fair notice and reasoned decisionmaking demand" that an adjudicatory decision provide "with some degree of specificity" the standard against which the member's conduct is judged); *id.* at 226 ("When an agency utterly fails to provide a standard for its decision, it runs afoul of more than one provision of the Administrative Procedure Act").

[3] Writing for the court below, Judge Straub (at App. 44-45) quotes from his opinion for the court in *Perez v. Hoblock*, 368 F.3d 166, 174 (2d Cir. 2004): "Thus, although the prohibition [here] . . . is admittedly flexible, and officials implementing this standard will undoubtedly exercise some discretion in interpreting and applying the regulation, our primary focus must be on whether the specific conduct at issue in this case falls with sufficient clarity within the ambit of the regulation. . . ."

lengthy opinion makes clear, the applicable NYSE rule and Commission precedents had not articulated the governing standard with clarity or consistency. Once more in contrast, the D.C. Circuit has stated that agency "ad hocery" in the application of precedent warrants no deference. *Ramaprakash v. FAA*, 346 F.3d 1121, 1130 (D.C. Cir. 2003) (Roberts, J.)

The D.C. Circuit applied the requirement of an ascertainably certain standard in a trio of decisions reviewing SEC disciplinary action under its Rule 102(e)(1)(ii), which authorized the SEC to discipline practitioners found "to be lacking in character or integrity or to have engaged in unethical or improper professional conduct." *See Checkosky v. SEC*, 23 F.3d 452, 468 (D.C. Cir. 1994) ("*Checkosky I*"); *Checkosky II*, 139 F.3d at 223 n.1; *Marrie*, 374 F.3d at 1201.[4]

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[4] The D.C. Circuit's line of "ascertainably certain" cases began with *Gates & Fox Co. v. OSHRC*, 790 F.2d 154, 156 (D.C. Cir. 1986) (Scalia, J.). *General Electric Co.* provided the most frequently quoted formulation: "If, by reviewing the regulations and other public statements issued by the agency, a regulated party acting in good faith would be able to identify, with 'ascertainably certainty,' the standards with which the agency expects parties to conform, then the agency has fairly notified a petitioner of the agency's interpretation." 53 F.3d at 1329 (citation omitted). In contrast, where "regulations and other policy statements are unclear, where the petitioner's interpretation is reasonable, and where the agency itself struggles to provide a definitive reading of the regulatory requirements, a regulated party is not 'on notice' of the agency's ultimate interpretation of the regulations, and may not be punished." *Id.* at 1334.

Checkosky I remanded for further explanation a Commission opinion that "declared that bad faith is not a prerequisite for a violation" of the rule, but which did "not specify the state of mind both necessary and sufficient to constitute a violation" of that rule. 23 F.3d at 458. In *Checkosky II*, the D.C. Circuit found – following the remand – that the SEC had again failed to provide a "clear mental state standard to govern Rule 2(e)(1)(ii)" and remanded the case with instructions that the charge be dismissed. 139 F.3d at 225, 227. The SEC argued in *Checkosky II* that disciplining the practitioners was necessary to effectuate the public policy purposes for which the rule was promulgated. The D.C. Circuit responded that (i) "[h]owever legitimate and, indeed, essential the Commission's concern . . . may be, it is no substitute for a clearly delineated standard," and (ii) the Commission's position came "close to a self-proclaimed license to charge and prove improper professional conduct whenever it pleases." 139 F.3d at 225.

Marrie recounted how the D.C. Circuit, in *Checkosky*, "engaged in an extended dialogue with the Commission about its standard for sanctioning professionals for 'improper professional conduct.'" 374 F.3d at 1202. "[T]he Commission on remand had simultaneously embraced and rejected standards of recklessness, negligence and strict liability, with no guidance as to which standard it had relied upon in finding a violation of the Rule." *Id.* at 1203. Between the dates of the *Checkosky II* and *Marrie* opinions, the SEC finally defined the mental state

standard for "improper professional conduct" in a way which the D.C. Circuit held in *Marrie* was clear. 374 F.3d at 1203, 1209. But *Marrie* reversed a finding of guilty because – at the time of the allegedly violative conduct – "there was no 'ascertainably certain' standard for finding 'improper professional conduct' under Rule 102(e)." *Id.* at 1206.

The precise administrative lapses overturned by the D.C. Circuit are present here and left undisturbed by the Second Circuit. Neither the NYSE nor the SEC made a finding either (i) as to Heath's mental state, or (ii) the mental state necessary for a breach of confidentiality to be "unethical." The most the NYSE offered is that "unethical conduct" can be "something broader than bad faith." App. 111. Enforcement took the position that "the disclosure of confidential information," "under all imaginable circumstances is by definition unethical conduct" but that it "may decide in [its] discretion . . . [to] not prosecute" depending on the circumstances; Enforcement added only that it does not believe "strict liability is the standard" for "unethical conduct." The practical effect is to permit the NYSE to charge and prove "unethical conduct" whenever it pleases. The D.C. Circuit – in contrast – does require proof of a mental state. *See Halvonik v. Dudas*, 398 F. Supp. 2d 115, 124 (D.D.C. 2005) (an "agency must . . . provide reasonable notice of the offense itself, including the required mental state, necessary to constitute a violation of the rules"), *aff'd*, 192 F. App'x 964 (D.C. Cir. 2006).

Heath based his defense at each stage of the proceedings below on the argument that the NYSE must prove he acted in "bad faith" in order to find him guilty of violating the J&E Rule. He did so because broad language in *Buchman v. SEC*, 553 F.2d 816 (2d Cir. 1977), appeared to require proof of "bad faith" to convict a member for violating the J&E Rule, and because the SEC's two most recent decisions under the J&E Rule (before this case) expressly stated that "bad faith" was required to convict. *See Nicholas T. Avello*, Exchange Act Release No. 51,633, 2005 WL 1006827, at *3 (Apr. 29, 2005) ("When a violation of Conduct Rule 2110 is not based on the violation of some other rule, we have required a showing that the respondent has acted in bad faith before liability can be found."), *aff'd sub nom. Avello v. SEC*, 454 F.3d 619, 627 (7th Cir. 2006) ("But the Commission does not require a finding of bad faith when the predicate for violating Rule 2110 is the violation of another NASD or Exchange Act rule."); *Calvin David Fox*, Exchange Act Release No. 54,840, 89 SEC Docket 1156, 2006 WL 3455114, at *2 n.3 (Nov. 30, 2006) ("*Fox II*") (describing SEC jurisprudence as "holding that if only violation alleged by NASD is failure to observe just and equitable principles of trade, there must be a finding of bad faith.").

The court below (like the SEC) held that the "bad faith" requirement expressed in *Buchman* applies only in cases where the issue is whether a breach of contract amounted to conduct "inconsistent with just and equitable principles of trade." But before its opinion in this case, the SEC had never expressly

stated that *Buchman* applied only to breach of contract cases, and its case law in no way provided an "ascertainably certain" standard of such a limitation on *Buchman*.

In *Buchman*, the Second Circuit stated:

> The touchstone, in other words, is good faith — the ultimate test of violation of an ethical standard. A breach of contract is unethical conduct in violation of NASD Rules only if it is in bad faith, just as conduct violates rule 10b-5 only if there is scienter: intent to deceive, manipulate or defraud. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 96 S. Ct. 1375, 47 L.Ed.2d 668 (1976). The measure of culpability then becomes whether the appellants were in good faith.

553 F.2d at 821 (emphasis added). After *Buchman*, only one Commission decision, *William D. George, III*, Exchange Act Release No. 17,136, 20 SEC Docket 1374, 1980 WL 27420, at *2 (Sept. 8, 1980), held that a breach of contract does not violate ethical standards unless the member "acted in bad faith" (without, however, stating that "bad faith" applies only in breach of contract cases). But then came the Commission's decision in *Robert J. Jautz*, Exchange Act Release No. 24,346, 38 SEC Docket 91, 1987 WL 757991 (Apr. 15, 1987) – a frequently cited case in the Commission's J&E Rule jurisprudence – holding that a breach of contract violates the J&E Rule if "committed in bad faith or is accompanied by unethical conduct." *Id.* at *2 (citing *Buchman* and

George). *Jautz* did not state any intent to depart from *Buchman*, yet *Jautz* injected "or is accompanied by unethical conduct" into a formulation addressing a breach of contract without explaining the derivation or meaning of "or is accompanied by unethical conduct."[5] Then, in *Avello* (2005) and *Fox II* (2006), the Commission held in non-breach of contract cases that "bad faith" must be shown to prove a violation of the J&E Rule.

Confronted with its own recent cases, the Commission held that the language in *Avello* and *Fox II* on which Heath relied was only dicta, placing the onus on the regulated class to distinguish between supposed dicta and holdings to comprehend the rule. In a telling move, the Commission's staff attorneys – after the Commission's opinion in this case – argued to the court below that *Avello* and *Fox II* were "incorrect." The court below accepted this negation of Commission precedents, improperly applying the "corrected" case law to Mr. Heath's case retroactively. *See Auer v. Robbins*, 519 U.S. 452, 462 (1997) (according deference only when an agency's legal brief was not "a 'post hoc rationalizatio[n]' advanced

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[5] *See also Daniel Joseph Alderman*, Exchange Act Release No. 35,997, 59 SEC Docket 2075, 1995 WL 442069, at *2 n.13 (July 20, 1995) (citing both *Jautz* and *George* as holding that "breach of contract violates NASD Rules where bad faith or unethical conduct evidenced"), *aff'd sub nom. Alderman v. SEC*, 104 F.3d 285 (9th Cir. 1997); *Leonard John Ialeggio*, Exchange Act Release No. 37,910, 63 SEC Docket 295, 1996 WL 632974, at *4 (Oct. 31, 1996) (stating the holding in *Buchman* as applying "bad faith or unethical conduct" in a breach of contract case).

by an agency seeking to defend past agency action against attack"). Had the court below focused on the absence of an ascertainably certain standard, it would have seen in these "incorrect" decisions as well as in the Chief Hearing Officer's decision in this case – which failed to perceive that *Buchman* was limited to breach of contract cases – proof that "even the [NYSE and Commission's] own interpretive bodies were unable to discern clearly" what the J&E Rule required. *Gen. Elec. Co.*, 53 F.3d at 1333.[6]

The court below tried to answer Heath's fair notice argument in its assertion that "the SEC has made clear that no scienter is required and mere unethical conduct is sufficient outside of the breach of contract context." App. 43. The first prong is a

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[6] If *Avello* and *Fox II* are properly classified as dicta, then the Commission and the court below relied on dicta to support their contention that Commission precedents supposedly stated that (outside the breach of contract area) a violation of the J&E Rule could be shown by "bad faith or unethical conduct." Thus, the Commission and the court below relied on *Calvin David Fox*, Exchange Act Release No. 48,731, 81 SEC Docket 1511, 2003 WL 22467374 (Oct. 31, 2003) ("*Fox I*"), but *Fox I* never discussed the formulation to be used in non-breach of contract cases versus breach of contract cases; *Fox I* only stated in passing dicta that "we have held that a self-regulatory organization need not find that the respondent acted with scienter, but must find that the respondent acted in bad faith or unethically." *Id.* at *3. Similarly, the court below treated as "[d]irectly on point" *Robert E. Kauffman*, Exchange Act Release No. 33,219, 55 SEC Docket 1287, 1993 WL 483323, at *1-*2 (Nov. 18, 1993), *aff'd sub nom. Kauffman v. SEC*, 40 F.3d 1240 (3d Cir. 1994), which involved a member found to have acted both in bad faith and unethically. App. 27.

red herring: Heath never contended that "scienter" must be shown; on the contrary, the Second Circuit's formulation in *Buchman* on which Heath relied expressly differentiated the scienter requirement attached to Rule 10b-5 and the "bad faith" requirement attached to the J&E Rule.[7] The second prong's assertion that the SEC has made clear "mere unethical conduct is sufficient outside of the breach of contract context" cannot survive a review of the actual decisions. Before the Commission's decision in this case, a regulated party acting in good faith would not be able to identify with "ascertainable certainty" the standard being applied to either the breach of contract or the non-breach of contract context because – with the exception of *George* – none of the other precedents applied "bad faith" to the breach of contract context and "bad faith or unethical conduct" to the non-breach of contract context.

The court further stated that "the SEC has made clear that industry norms and fiduciary standards are determinative as to what constitutes unethical conduct" and that "any reasonably prudent securities professional would recognize that the disclosure of

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[7] As shown in n. 6, *supra*, the Commission's decision in *Fox I* which is pivotal to the analysis of the court below also differentiates between "scienter" (which need not be shown under the J&E Rule) and "bad faith or unethically" (which the Commission says must be shown). The court's assertion that "the SEC has made clear that no scienter is required" accordingly provides no support for the court's holding that Heath had fair notice of what conduct could be sanctioned; pronouncing that "no scienter is required" leaves undefined what is required.

confidential client information under the circumstances of this case constitutes unethical conduct sanctionable under the J&E Rule." App. 46-47. This part of the opinion sharply frames the fundamental import of the conflict between the D.C. and Second Circuits. The court below did not determine whether the SEC had articulated and applied an "ascertainably certain" standard – and it had not. It was not ascertainably certain that Heath could be convicted for "unethical conduct" in the absence of bad faith, and "industry norms" and "fiduciary standards" cannot fill the gap in the undefined "unethical conduct" standard – just like a reference to GAAP and GAAS in and of itself did not provide an ascertainably certain standard for "unprofessional conduct" under SEC Rule 102(e). *See Marrie*, 374 F.3d at 1203.

Paraphrasing *Marrie*, even if Heath knew that he "would be held to certain professional standards," he was still entitled to "more specific guidance as to [the NYSE's] interpretation of the [J&E] Rule"; "there was no way of knowing in advance what kind of errors – non-negligent, innocent mistakes or isolated, serious deviations" – as to the duty of confidentiality would violate the J&E Rule. *Id.* at 1207, 1203. The Second Circuit's failure to require an "ascertainably certain" standard for the J&E Rule – in conflict with the precedents of the D.C. Circuit – constitutes a compelling reason for granting the petition.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

August Term, 2009

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Decided: November 4, 2009)

Docket No. 09-0825-ag

THOMAS W. HEATH III,

Petitioner,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

Before:
STRAUB AND WESLEY, *Circuit Judges*
AND GARDEPHE, *District Judge*.*

Petitioner Thomas W. Heath III appeals from the Opinion and Order of the Securities and Exchange Commission ("SEC"), affirming the New York Stock Exchange LLC's ("NYSE") finding that Petitioner

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* The Honorable Paul G. Gardephe, United States District Judge for the Southern District of New York, sitting by designation.

violated NYSE Rule 476(a)(6) by disclosing a client's confidential information to a third party. Rule 476(a)(6) – the so-called "J&E Rule" – subjects registered members to disciplinary sanctions for engaging in "conduct or proceeding inconsistent with just and equitable principles of trade." The NYSE found that, although Petitioner did not act in bad faith, he engaged in unethical conduct in violation of the J&E Rule. Petitioner now appeals the SEC's Opinion and Order, arguing that: (1) bad faith, and not mere unethical conduct, was required to sustain the J&E Rule violation; (2) alternatively, if the J&E Rule does in fact prohibit mere unethical conduct in this case, it failed to provide adequate notice that his conduct was sanctionable; and (3) the NYSE improvidently granted summary judgment against him by failing to resolve questions of fact and draw reasonable inferences in his favor. Because we conclude that Petitioner's arguments lack merit, we deny the Petition.

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Randall W. Quinn, Assistant General Counsel), Washington, D.C., *for Respondent.*

STRAUB, *Circuit Judge*:

Petitioner Thomas W. Heath III appeals from the Opinion and Order of the Securities and Exchange Commission ("SEC"), affirming the New York Stock Exchange LLC's[1] ("NYSE") finding that Petitioner violated NYSE Rule 476(a)(6) by disclosing a client's confidential information to a third party.[2] Rule 476(a)(6) – the so-called "J&E Rule" – subjects registered members to disciplinary sanctions for engaging in "conduct or proceeding inconsistent with just and equitable principles of trade." The NYSE found that, although Petitioner did not act in bad faith, he engaged in unethical conduct in violation of the J&E Rule. On appeal to the SEC, Petitioner argued that bad faith is required to sustain a J&E Rule violation. The SEC held that a finding of mere unethical conduct was sufficient to sustain a J&E Rule violation

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[1] Subsequent to the conduct at issue here, the SEC approved proposed rules that transferred the member firm regulatory functions of the New York Stock Exchange, Inc. to the National Association of Securities Dealers, Inc. ("NASD"), which thereafter changed its name to the Financial Industry Regulatory Authority, Inc. *See* SEC Notices, Release No. 34-56145, 72 Fed. Reg. 42169-01, 2007 WL 2186069 (Aug. 1, 2007).

[2] The NYSE censured Petitioner and fined him in the amount of $100,000. Petitioner appeals only the liability determination and not the sanction.

for a breach of confidence and affirmed the NYSE's finding that he violated the Rule by making the disclosure. Petitioner now appeals the SEC's Opinion and Order, principally arguing that bad faith, and not mere unethical conduct, was required to sustain the J&E Rule violation. He argues alternatively that, if the J&E Rule does in fact prohibit mere unethical conduct in this case, it failed to provide adequate notice that his conduct was sanctionable. Finally, he argues that the NYSE improvidently granted summary judgment against him by failing to resolve questions of fact and draw reasonable inferences in his favor. Because we conclude that Petitioner's arguments lack merit, we deny the Petition.

BACKGROUND

I. Factual Background

Petitioner joined J.P. Morgan Securities as an investment banker in its Financial Institutions Group in 1992, where he advised financial institutions in connection with mergers and acquisitions. He ultimately became a Managing Director and remained with J.P. Morgan until 2005.

Hibernia Bank was a client of J.P. Morgan. Petitioner covered the account for nine years. Petitioner testified that he was close to the CEO of Hibernia, both professionally and personally. Through this relationship, he secured J.P. Morgan's engagement as Hibernia's financial advisor in connection with its merger with Capital One Corp. Hibernia "formally

engaged" J.P. Morgan in this capacity on February 25, 2005.

In mid-January of that year, Antonio Ursano, Global Head of Bank of America's Financial Institutions Group, contacted Petitioner, unsolicited, and proposed that Petitioner join Bank of America as the sole head of its bank group. Petitioner met with him and initially indicated he was not interested. They met again, at Ursano's insistence, and Ursano offered Petitioner a job for two years at $3 million per year, with the understanding that he would be promoted within the year to succeed Ursano as head of Bank of America's Financial Institutions Group. Petitioner said that he would consider it, and, on February 13, 2005, he gave Ursano a verbal commitment to join Bank of America (pending a written agreement).

Ursano asked Petitioner to begin in one week, but Petitioner said "that he was working on a large transaction which he felt he needed to complete both in the interest of his client and of his current employer." He did not disclose any further details regarding the "transaction" at that time. While he did not say so explicitly to Ursano, Petitioner was referring to the Hibernia and Capital One merger. Petitioner believed that leaving J.P. Morgan without closing the Hibernia and Capital One deal would be disruptive to the transaction, and to Hibernia particularly.

On February 18, Petitioner informed Tim Main, his supervisor at J.P. Morgan, that he intended to join

Bank of America, but that he would stay at J.P. Morgan to secure the Hibernia engagement and "get the deal across the finish line." Main agreed that it was the "honorable" thing to do. Petitioner emphasizes that he had no monetary interest in completing the acquisition at J.P. Morgan and he intended to forfeit any deal-based bonus by resigning prior to fiscal year end.

Ursano asked Petitioner to meet Eric Corrigan, the then-head of Bank of America's Depository Institutions Group, who would have reported to Petitioner upon his arrival. They met on February 23. The purpose of their meeting was to get acquainted with each other and to begin developing a working relationship. They did not discuss Hibernia at this meeting. Petitioner testified that Corrigan seemed to think that they were going to be co-heads of the bank group and not that Petitioner was coming on as the sole head.

Two days later, on February 25, Petitioner received an offer letter from Bank of America, which stated that he would join as a Managing Director and head of banks for the Financial Institutions Group (reporting to Ursano, who was the head of the Financial Institutions Group) with compensation of approximately $6 million over two years.

On March 1, Ursano asked Petitioner to discuss with Corrigan how they were going to work out coverage on their joint accounts, and to assure Corrigan that he was a "decent guy" and a "good

partner" who was "not going to stomp all over him" on those accounts. Petitioner and Corrigan had a phone conversation that day during which Petitioner made suggestions about how Corrigan could get involved in Petitioner's accounts and invited Corrigan to meet with a number of his clients. Petitioner testified that his objective was to "build [Corrigan] up" and to let him know that he had heard "nice things" about him from clients, and that he would be "there to help out" if Corrigan needed it.

Near the end of this conversation, Corrigan asked about Petitioner's pending transaction, stating that "there are a lot of rumors out in the marketplace. And [we] . . . know you have a bank deal somewhere down in the south." Petitioner testified that he initially refused to divulge any information regarding the Hibernia acquisition, but eventually responded: "if you really want to know, I will tell you exactly what it is, but you have to understand, you know, I've got a week to go. This is obviously confidential information. The deal is done, bankers have been hired, nothing is going to change. And you just have to understand and respect that." Corrigan replied, "well, are you comfortable telling me?" Petitioner responded, "the real question is, are you comfortable with me telling you because you're the one that can't act on this in any way." Corrigan replied, "I can understand that, I can keep a secret." At that point, Petitioner disclosed that Capital One was acquiring Hibernia; J.P. Morgan was representing Hibernia in the deal; forty-five percent of the deal was being funded with

cash; the deal had been in motion before January; and Hibernia believed that Capital One's price-to-earnings ratio was sufficiently low that it gave Hibernia a "degree of comfort with the stock."

Petitioner testified that he disclosed this information to Corrigan for "a couple of reasons":

> I think that you have to understand that I was talking to someone who, as the gray area merged, was increasingly more of a colleague. And I realize that that is technically not what was going on, but the whole gist of the conversation was business going forward. The – the – you know, the conversation itself, I had mentioned that, you know – I said, well, there's a good marketing piece that we'll talk about going forward. . . . I'm dealing with someone who's going to be a colleague. I'm dealing with someone who the whole purpose of this thing is to build trust and – and build a collegiality with. I'm – the conversation has gone more towards marketing and this deal had direct relevance. The final thing that I will tell you is when he says they are hearing rumors and they know I've got something in the south, I mean, my forehead just beaded up with sweat, I'm terrified. And my view was – that I basically put a firewall around the problem and I sincerely believe that. And I know in hindsight that is incredibly stupid particularly given what happened. But understand, I knew with 100 percent certainty there was zero role for – for B of A in that deal, zero.

Throughout his testimony, Petitioner emphasized that he was attempting to prevent Corrigan and others at Bank of America from "snooping" around the deal. As he put it, he was attempting to "put a firewall around the problem."

Corrigan confirmed to Petitioner that he understood that he could not act on the information in any way, and Petitioner believed that Corrigan, an experienced industry professional and future colleague, would keep the information confidential as he had promised. That same day, however, Corrigan disclosed the information to Thomas Chen, the head of Bank of America's Diversified Financial Services Group. Chen in turn left a voicemail message for the head of Capital One's mergers and acquisitions group, inquiring whether there was a role for Bank of America on the deal.

On March 3, while Petitioner was in a meeting at Bank of America, Corrigan invited Petitioner to stop by his office. During their conversation, Corrigan asked Petitioner how the Hibernia deal was going and whether there was room for another advisor on the merger. Petitioner testified that he was emphatic in saying that there was no way that could happen and that he thought he had made that "abundantly clear" in their prior conversation and he was shocked that Corrigan even asked. He made clear that "it's Morgan and Bear Sterns [at Hibernia] and at Capital One it's Credit Suisse First Boston and nothing is going to change." Corrigan made no mention of the

call to Capital One or the fact that he disclosed the information to Chen.

On March 6, the merger agreement between Hibernia and Capital One was signed and announced by *The Wall Street Journal*. The total transaction was valued at approximately $5.3 billion, representing a 24% premium or approximately $1 billion over the closing price of Hibernia shares on Friday, March 4. As Petitioner had disclosed to Corrigan, Credit Suisse First Boston acted as financial advisor to Capital One, and J.P. Morgan and Bear Stearns acted as financial advisors to Hibernia (with J.P. Morgan as the lead advisor). Neither the terms of the deal nor the parties' financial advisors had changed since Petitioner's March 1 conversation with Corrigan.

That same day, Alex Lynch, a colleague of Petitioner's from J.P. Morgan, informed Petitioner that there was "a problem." He said that Capital One received a call from Bank of America in an attempt to get itself retained, armed with "very explicit information" about the merger with Hibernia. Lynch said that "they had everything. . . . it was as if you had handed them a term sheet and they used it. . . . [W]hen we connected the dots and add it all up, it points directly at you." Petitioner was immediately put on leave.

Petitioner spoke to Corrigan that day and told him that a colleague from J.P. Morgan had told Petitioner that Bank of America approached Capital One in an attempt to get itself retained with specific

details of the merger. Corrigan denied disclosing the information. Petitioner did not tell Corrigan at this point that he was put on leave. The next day he asked Corrigan again. This time Corrigan said that he "kind of did" disclose the information. Corrigan denied revealing Hibernia's role in the merger to Chen, but admitted that he suggested to Chen that the rumors that Capital One was involved in a merger were true. Petitioner then spoke to Chen, and Chen said that when he called Capital One, he mentioned only that he was aware that Capital One was involved in a bank deal.

Petitioner disclosed the entire situation to Ursano at Bank of America and recommended that he "elevate this internally to the top of the house immediately." Over the next two days, a Bank of America investigative team interviewed Corrigan, Chen and Petitioner, and, on March 1, Bank of America's counsel informed Petitioner's counsel that Bank of America believed that Petitioner did not act with any devious or malicious intent, but had made an error in judgment. On March 15, 2005, Bank of America "revoked" its offer of employment to Petitioner and fired Corrigan and Chen. J.P. Morgan had fired Petitioner the day before.

II. NYSE Proceedings

On January 25, 2006, the NYSE Division of Enforcement ("Enforcement") charged that Petitioner's disclosure violated NYSE Rule 476(a)(6), which

prohibits conduct inconsistent with just and equitable principles of trade. Enforcement filed a motion for summary judgment on October 18, 2006, and Petitioner filed a competing motion on October 26, 2006. On November 24, 2006, the NYSE Hearing Board ("Hearing Board") granted summary judgment on liability against Petitioner, finding that he violated the J&E Rule by making the disclosure to Corrigan.[3]

First, the Chief Hearing Officer cited NYSE Rule 476(c), which grants a hearing officer the authority to "resolve any and all procedural and evidentiary matters and substantive legal motions." *In the Matter of NYSE Disciplinary Proceedings Against Thomas W. Heath, III*, NYSE Hearing Bd. (Nov. 24, 2006), SPA at 23.[4] She concluded that "[t]his includes the authority to consider and, if warranted, grant a motion for summary judgment." *Id.* She held that "[a] Hearing Officer's power to decide a summary judgment motion under NYSE Rule 476(c) is analogous to that of a federal court deciding a summary judgment motion under Rule 56." *Id.* at 24.

The Chief Hearing Officer explained that Petitioner's main argument is that "to prevail on its charge . . . , Enforcement must show that [he] acted in bad faith." *Id.* at 25. She disagreed, holding that

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[3] A single hearing officer issued the summary judgment decision.

[4] SPA refers to the Special Appendix submitted by Petitioner in support of his brief.

"[a] violation of the just and equitable principles of trade codified by NYSE Rule 476(a)(6) may occur either through bad faith or unethical conduct." *Id.* She cited several SEC decisions for this proposition and concluded that "the concept of unethical conduct is different from–namely, that it is broader than–bad faith." *Id.*

The Chief Hearing Officer then found that by disclosing confidential information, Petitioner had acted unethically. She reasoned: "There is no dispute that the information that [Petitioner] disclosed to Corrigan included sensitive, nonpublic details of a transaction that had not yet been consummated. . . . It is commonly accepted that when a financial advisor takes on work that requires the communication of such sensitive, nonpublic information from the client to the advisor, the client has an expectation that the advisor will keep that information confidential." *Id.* at 27. She noted that "[i]t is undisputed that [Petitioner's] employer had a Code of Conduct that spelled out the duties of an employee to keep confidential certain sensitive information learned on the job." *Id.* at 27. She concluded:

> But the duty of confidentiality at issue here stems not only from the explicit Code of Conduct, but also from the ethical obligation to which every financial advisor becomes subject upon learning of sensitive, nonpublic information about a client in the normal course of business. It is a duty that should be self-evident to any experienced financial

> professional. By disclosing confidential information about the pending transaction to someone who, at the time of the disclosure, was an employee of a competitor firm, [Petitioner] breached the duty that he owed to his client and thereby violated the just and equitable principles of trade.

Id. (footnote omitted).

In support of his summary judgment motion, Petitioner submitted a letter, dated February 10, 2006, from Randall Howard, Hibernia's President of Commercial Banking and a member of its board of directors at the time of the merger with Capital One. The letter stated:

> I am comfortable and confident in [Petitioner's] judgment that his disclosure to a B of A subordinate was made in strict confidence with no intention that the individual would breach that confidence in any way. Moreover, at the point of the disclosure all terms of the transaction and hiring of bankers had been finalized, and the deal was in effect completed. Given the circumstances, I do not view Tom's discussion as a breach of our confidence. Had we known about this at the time, there is no remedial or regulatory action we would have sought.
>
> I have known Tom for many years. He has always been an honest, straightforward banker, and our thoughts of him are evidenced by the fact that we looked to him as our advisor for our most important

> transaction. I absolutely would work with Tom again should the opportunity present itself and entrust him with the most guarded of confidences. His year-long absence from the industry leaves a large gap which has not been filled.

The Chief Hearing Officer noted that the "letter was prepared and submitted long after the breach occurred and apparently in the executive's personal capacity, rather than on behalf of the client." *Id.* at 27-28 n.3. She concluded, "In the absence of any contemporaneous waiver by his client, [Petitioner]'s obligation to maintain the confidentiality of his client's information is unaffected." *Id.* She also found that there was no competing obligation or equitable excuse to justify Petitioner's action. She explained:

> Nothing in the record would indicate that [Petitioner], in the instant matter, was under any competing obligation to make the disclosures that he did or that any "equitable excuse" relieved him of his ethical obligation to keep the information confidential. Rather, his reasons for making the disclosures–while certainly lacking any malevolent or deceitful quality–were, in the final analysis, self-serving in that they were intended to gain the trust of, and thereby smooth things over with, a soon-to-be colleague. [Petitioner] admits that he made the disclosures, at least in part, to make Corrigan "understand that he was going to be a good partner and that he was not going to 'stomp all over him.'" On the record before me, I cannot find anything

> that excuses the unethical conduct in which [Petitioner] engaged.

Id. at 29 (citation and footnote omitted).

In a footnote, the Chief Hearing Officer also dismissed Petitioner's explanation that he made the disclosures in order to preempt Corrigan from "snooping" around the deal and acting on the information in the market place. She wrote:

> Even assuming it were true, as I must for purposes of deciding Enforcement's Motion, I do not find that this concern rises to the level of a competing obligation or "equitable excuse" that absolves [Petitioner] of his breach of confidentiality. On the contrary, if [Petitioner] suspected that Corrigan might "snoop around the deal" for the purposes of "acting on information in the market place," [Petitioner] could ha[illegible]e—and, indeed, should have—taken other steps to prevent such a result, such as alerting his current and future employers, as well as his client, to his suspicions. If anything, those suspicions regarding Corrigan should have made [Petitioner] even more reluctant to divulge sensitive information to his would-be colleague and, thus, only served to heighten [Petitioner]'s ethical obligation to safeguard his client's confidential information against incursion by this potentially untrustworthy individual.

Id. Finally, the Chief Hearing Officer rejected Petitioner's argument that summary judgment should not be granted because neither his former firm nor his

former client were injured as a result of the disclosure. She wrote, "There can be no question that the disclosures that [Petitioner] made did have the potential for unraveling the deal. Had that occurred, many investors could have been harmed–not merely [Petitioner]'s client or his firm, but also the shareholders of those organizations." *Id.* at 30. She granted summary judgment against Petitioner, finding him guilty of violating the J&E Rule, and indicated that the penalty would be imposed after a hearing at a future date.

Thereafter, a NYSE Hearing Panel ("Panel") was convened to hear evidence and argument concerning the penalty to be imposed. It heard testimony of several witnesses, namely, a then-current managing director at J.P. Morgan who was Petitioner's colleague, Randall Howard (the former member of Hibernia's board of directors who wrote the letter discussed *supra*), an attorney who was a close colleague of Petitioner and worked as general counsel and as an investment banker at J.P. Morgan, and Petitioner himself. Petitioner testified, in particular, that the disclosure came in the last two minutes of a forty-one minute telephone conversation, while he was packing his bags in a hotel room.

Enforcement argued for a penalty of censure, a six-month bar and a $200,000 fine. It maintained that this was a case of first impression, in which an investment banker had disclosed a client's confidential information and, therefore, "there is no relevant precedent to aid the Panel." It emphasized that

(1) Petitioner's breach was not a mistake; (2) after his breach, he did nothing to alert J.P. Morgan or Hibernia; (3) at the time of the breach, there was potential for harm, such as an unraveling of the deal or volatility in the market; (4) as an experienced investment banker, he should have known better than to disclose confidential, non-public information; (5) a less severe penalty would not deter others similarly situated; and (6) given the large amount of income he was earning, $200,000 was a relatively small fine.

Petitioner, for his part, argued that his disclosure did not cause any harm and the potential for harm was low because the deal was finalized, and that he was not personally enriched by his disclosure. He emphasized that he had already incurred a very high personal cost, including the loss of a minimum annual income of $3 million for 2005 and 2006 and his inability to find work in the twenty-two months following the incident. He contended that he did not act in bad faith, nor was there any evidence of such; rather, his disclosure was "a spontaneous thing that happened in the 38th or 39th minute of a 41-minute conversation . . . where he was kind of blindsided . . . [because] he didn't expect this to come up, had never anticipated it coming up, [and] never planned on having this conversation." Finally, he pressed that he had been, at all times, candid and forthcoming during the investigation and disciplinary proceedings surrounding his disclosure. Petitioner argued that, under

these circumstances, a letter of admonition would be most appropriate.

After the hearing, the Panel issued its decision dated March 15, 2007. The Panel found "the nature of the violation in this case to be very serious, warranting a serious penalty." *In the Matter of Thomas Woodley Heath, III, Former Registered Representative*, NYSE Hearing Bd. Decision 07-25, 2007 WL 3408256, at *4 (Mar. 15, 2007). It emphasized the potential of harm that the disclosure had, but found that, comparatively speaking, the risk was small given the advanced stage of the deal.

The Panel also found that Petitioner "lacked any bad faith." *Id.* at *5. It explained that Petitioner "only shared the confidential information with [Corrigan] after making the latter promise that he would not share it with anyone else, and [Petitioner] had every reason to believe that [Corrigan] would keep his promise." *Id.* It credited Petitioner's testimony that he made the disclosure without "premeditation" and only as a result of a "momentary lapse in judgment." *Id.* It found that Petitioner "used poor judgment and was motivated by a desire to gain the trust of a future colleague," but "was not motivated by any improper goal of personal enrichment, nor did he obtain any." *Id.* at *6. Finally, the Panel emphasized that Petitioner's wrongdoing stemmed from a single act of indiscretion against a backdrop of an otherwise unblemished career. It found that Petitioner was not likely to repeat his mistake. Accordingly, it concluded

that a $200,000 fine was punitive, and instead imposed a penalty of censure and a $100,000 fine.

In a two paragraph decision dated October 17, 2007, the NYSE Board of Directors affirmed the Chief Hearing Officer's summary judgment decision and the penalty imposed by the Panel. On November 15, 2007, Petitioner filed an appeal with the SEC. *See* 15 U.S.C. § 78s(d)(2).

III. SEC Opinion

Petitioner advanced three arguments to the SEC on appeal. Specifically, he argued that: (1) the J&E Rule requires a finding of bad faith; (2) alternatively, he did not receive fair notice that his conduct was sanctionable under the J&E Rule; and (3) the NYSE erred by determining his guilt on a motion for summary judgment. The SEC rejected all three of his arguments and affirmed the NYSE's decisions. *See In the Matter of the Application of Thomas W. Heath, III*, Release No. 59,223, 94 S.E.C. Docket 3466, 2009 WL 56755 (Jan. 9, 2009).

A. Bad Faith Argument

First, the SEC held that it has "long applied a disjunctive 'bad faith or unethical conduct' standard to disciplinary action under the J&E Rule." *Id.* at *4. It explained:

> This rule incorporates "broad ethical principles," and focuses on the "ethical implications

> of the [a]pplicant's conduct." The rule serves as an industry backstop for the representation "inherent in the relationship," between a securities professional and a customer, "that the customer will be dealt with fairly, and in accordance with the standards of the profession."
>
> Promulgated to discipline "a wide variety of conduct that may operate as an injustice to investors or other participants in the marketplace," the J&E Rule focuses on the securities professional's conduct rather than on a subjective inquiry into the professional's intent or state of mind. Accordingly, a violation of the rule need not be premised on a motive or scienter finding. . . .
>
> [Petitioner]'s breach of confidentiality violated one of the most basic duties of a securities professional, a duty that is grounded in fiduciary principles and reflected in the [J.P. Morgan] Code of Conduct.

Id. at *4-5 (footnotes omitted).

B. Fair Notice Argument

In the alternative, Petitioner argued to the SEC that he lacked notice that the J&E Rule could subject him to discipline for unethical conduct that was not motivated by bad faith. The SEC held that "[a]s an experienced investment banker, [Petitioner] can be fairly charged with notice that his breach of his duty to maintain the confidentiality of his client's

information violated the just and equitable principles of trade." *Id.* at *7. It further noted that Petitioner was on actual notice given that the J.P. Morgan Code of Conduct prohibited him from making such disclosures. The SEC emphasized that Petitioner testified that he had read the Code of Conduct and acknowledged that "one of the factors that creates a successful M & A banker is . . . having the judgment of how to use [confidential information] and how to use it in a trustworthy and honest way." *Id.* at *7 (internal quotation marks omitted; alterations in original).

C. Summary Judgment Argument

Finally, Petitioner argued to the SEC that the Chief Hearing Officer erred in granting Enforcement's motion for summary judgment because she did not resolve questions of fact and draw reasonable inferences in his favor. The SEC rejected this argument because it itself had "conducted a de novo review of the record." *Id.* at *10. In particular, it indicated that "[t]he record includes [Petitioner]'s on-the-record testimony taken by the Division during its investigation, and [Petitioner]'s testimony before the NYSE Hearing Panel during the penalty phase of the NYSE hearing." *Id.* Moreover, the SEC highlighted the fact that Petitioner "does not contest the material facts underlying the NYSE's finding of a violation of the rule, i.e., his disclosure of material non-public information regarding the pending merger of his

client and the circumstances surrounding his conversation with Corrigan." *Id.*

Petitioner now appeals the SEC's Opinion and Order. *See* 15 U.S.C. § 78y(a).

DISCUSSION

"In reviewing the SEC's opinion and order, we must affirm '[t]he findings of the Commission as to the facts, if supported by substantial evidence.'" *MFS Secs. Corp. v. SEC.*, 380 F.3d 611, 617 (2d Cir. 2004) (quoting 15 U.S.C. § 80b-13(a)). "The Administrative Procedure Act, which applies to our review of Commission orders, provides that a reviewing court shall 'hold unlawful and set aside agency action, findings, and conclusions found to be . . . arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law,' 5 U.S.C. § 706(2)." *Id.* (internal citation omitted).

I. Is Bad Faith Required for a J&E Rule Violation?

Petitioner's first argument is that a finding of bad faith is required for a J&E Rule violation, citing several SEC decisions and our decision in *Buchman v. SEC*, 553 F.2d 816 (2d Cir. 1977). It is clear, however, that the J&E Rule is concerned with enforcing ethical standards of practice in the securities industry and is violated by a breach of confidence if such breach amounts to unethical conduct.

The NYSE is a national securities exchange registered with the SEC pursuant to section 6 of the Securities Exchange Act of 1934, as amended ("Exchange Act"), 15 U.S.C. § 78f, *see Barbara v. N.Y. Stock Exch., Inc.*, 99 F.3d 49, 51 (2d Cir. 1996), and, as such, is a "self-regulatory organization" ("SRO"), *see* 15 U.S.C. § 78c(a)(26). It therefore has a duty to promulgate and enforce rules governing the conduct of its members. *See id.* §§ 78f(b), 78s(g); *see also Barbara*, 99 F.3d at 51. These rules are subject to SEC approval, *see* 15 U.S.C. § 78s(b); *Barbara*, 99 F.3d at 51, and must be "designed to . . . promote just and equitable principles of trade," 15 U.S.C. § 78f(b)(5).

While Congress enacted the Exchange Act to prohibit fraudulent practices in the securities industry, it recognized that such legislation "must be supplemented by regulation on an ethical plane in order 'to protect the investor and the honest dealer alike from dishonest and unfair practices by the submarginal element in the industry' and 'to cope with those methods of doing business which, while technically outside the area of definite illegality, are nevertheless unfair both to customer and to decent competitor, and are seriously damaging to the mechanism of the free and open market.'" VI LOUIS LOSS & JOEL SELIGMAN, SECURITIES REGULATION 2796 (3d ed. 2002) (quoting S. REP. NO. 75-1455 at 3 (1938); H.R. REP. NO. 75-2307 at 4 (1938)); *see also Avery v. Moffatt*, 55 N.Y.S.2d 215, 228, 187 Misc. 576, 592 (Sup. Ct. 1945) ("[S]ecurities trading is a highly

complex field in which it is not always feasible to define by statute or by administrative rules having the effect of law every practice which is inconsistent with the public interest or with the protection of investors. As a result there is a large area for the operation of Exchange rules on the level of business ethics rather than law, and in that sphere the statute leaves it to the Exchanges to carry on the necessary work of prevention and discipline."). Such "[r]egulation of the *ethics* of an industry means a substantial degree of *self*-regulation, properly supervised by government." LOSS & SELIGMAN, *supra*, at 2796; *see also Silver v. N.Y. Stock Exch.*, 373 U.S. 341, 352-53 (1963) (discussing Congress's intent for SROs to police the securities industry to reform unethical practices in the industry). Thus, in accordance with the Exchange Act, 15 U.S.C. § 78f(b)(5), the NYSE adopted, with the approval of the SEC, the J&E Rule, which prohibits registered members from engaging in "conduct or proceeding inconsistent with just and equitable principles of trade."

It has long been the view that the J&E Rule is designed to enable SROs to regulate the ethical standards of its members. *See, e.g.*, LOSS & SELIGMAN, *supra*, at 2809 n.30. SEC precedent is clear on this point. In *In the Matter of Benjamin Werner*, 44 S.E.C. 622, 1971 WL 120499 (July 9, 1971), the SEC rejected the petitioner's argument that NASD's J&E Rule[5]

[5] NASD's J&E Rule, Rule 2110 (previously Article III, § 1), provides: "A member, in the conduct of its business, shall

(Continued on following page)

could only be violated by an unlawful act. The SEC noted, "We have long recognized that [the J&E Rule] is not limited to rules of legal conduct but rather that it states a *broad ethical principle* which implements the requirements of Section 15A(b)" of the Exchange Act. *Id.* at *2 n.9 (emphasis added). It explained that "the NASD through its disciplinary powers can and should play an important role in improving the ethical standards of its members, subject always to their rights to obtain review by this Commission and the courts." *Id.* at *2; *see also In the Matter of the Application of William F. Rembert*, 51 S.E.C. 825, 1993 WL 483197, at *1 n.3 (Nov. 16, 1993) ("We have long recognized that [the NASD J&E Rule] *states broad ethical principles*. . . . Section 15A(b)(6) of the Exchange Act empowers self-regulatory organizations, such as the NASD, to discipline their members for unethical behavior, as well as violations of law." (emphasis added)); *In the Matter of the Application of Timothy L. Burkes*, 51 S.E.C. 356, 1993 WL 119769, at *3 (Apr. 14, 1993) ("As the Commission has stated previously, disciplinary hearings to require compliance with 'high standards of commercial honor and just and equitable principles of trade' are ethical proceedings; hence the concern is with ethical implications of the Applicant's conduct.").

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observe high standards of commercial honor and just and equitable principles of trade."

Directly on point is *In the Matter of the Application of Robert E. Kauffman*, 51 S.E.C. 838, 1993 WL 483323 (Nov. 18, 1993), *aff'd*, *Kauffman v. SEC*, 40 F.3d 1240 (3d Cir. 1994). There, the SEC affirmed NASD's findings that the petitioner violated NASD's J&E Rule by misrepresenting to NASD and to the Pennsylvania Securities Commission that he had received a bachelor's degree. *Id.* at *1. The petitioner argued that his misrepresentation was accidental and not in bad faith. *Id.* at *2. Although the SEC ultimately found that the petitioner had acted in bad faith, it rejected his argument that the J&E Rule required a finding of scienter. *Id.* It wrote:

> Kauffman argues that, in order to find liability under [NASD's J&E Rule], we must find scienter. We disagree. We have long recognized that [NASD's J&E Rule] states a broad ethical principle that implements the requirements of Section 15A(b) of the Securities Exchange Act of 1934. . . . The most that is required is a finding of bad faith *or unethical conduct*. Although Kauffman implies that the securities laws are designed solely for protection from fraud, and not merely unethical behavior, Section 15A(b)(6) of the Securities Exchange Act of 1934 empowers self-regulatory organizations, such as the NASD, to discipline their members for violations of just and equitable principles of trade.

Id. at *2 n.5 (emphasis added; internal citations omitted).

Similarly, in *In the Matter of the Application of Calvin David Fox*, 81 S.E.C. Docket 1511, 2003 WL 22467374 (Oct. 31, 2003) ("*Fox I*"), the SEC reviewed the NYSE's finding that the petitioner had violated the J&E Rule by making a misstatement to his member firm employer about the status of his license to practice law in the State of Florida and by submitting an altered copy of an order of the Florida Supreme Court to support the misstatement. *Id.* at *1. The petitioner argued that his statement that he was in good standing reflected his good faith legal opinion that his license suspension was stayed while the court considered his motion for rehearing. *Id.* at *2. He also contended that his submission of the altered order to his employer was inadvertent, and that he had intended to send it only to his family. *Id.* The SEC noted that "[w]ith respect to a charge that conduct was inconsistent with just and equitable principles of trade, we have held that a self-regulatory organization need not find that the respondent acted with scienter, but must find that the respondent acted in bad faith *or unethically.*" *Id.* at *3 (emphasis added).[6]

In *In the Matter of the Application of Paul K. Grassi, Jr.*, 86 S.E.C. Docket 1954, 2005 WL 3199274 (Nov. 30, 2005), the SEC addressed the proper

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[6] In *Fox I*, the NYSE did not make findings with respect to whether Fox acted in bad faith or unethically, and thus the SEC remanded for it to make such findings. *Fox I*, 2003 WL 22467374, at *3.

interpretation of NYSE Rule 476(a)(7), which prohibits members from engaging in "acts detrimental to the interest or welfare of the [NYSE]." *Id.* at *1 & n.1. In so doing, it drew upon its Rule 476(a)(6) jurisprudence, writing:

> Rule 476 states broad ethical principles that implement the requirements of Section 6(b) of the Exchange Act which, among other things, empowers self-regulatory organizations to discipline their members for unethical behavior as well as violations of law.
>
> In reviewing allegations that conduct is inconsistent with just and equitable principles of trade, we have held repeatedly that a self-regulatory organization's disciplinary authority is broad enough to encompass conduct that does not involve a security if that conduct reflects on a person's ability to comply with the regulatory requirements of the securities industry and to fulfill his fiduciary duties. . . . We have held that scienter is not required to establish a violation of such rules and that the most that is required is a finding of bad faith or unethical conduct.

Id. at *3, *4 n.8 (footnotes omitted); *see also In the Matter of Dep't of Enforcement v. Shvarts*, No. CAF980029, 2000 NASD Discip. LEXIS 6, at *16, 21 (June 2, 2000) ("'Bad faith' in the sense of malicious intent or deceitfulness need not be established. . . . [E]ven if the violation of the court order were not in

itself a violation of [the J&E Rule], Shvarts' conduct would still be violative because it was unethical.").

Courts have echoed this principle. As early as 1966, Judge Friendly noted that the J&E Rule is "something of a catch-all which, in addition to satisfying the letter of the statute, preserves power to discipline members for a wide variety of misconduct, including merely unethical behavior." *Colonial Realty Corp. v. Bache & Co.*, 358 F.2d 178, 182 (2d Cir.), *cert. denied*, 385 U.S. 817 (1966). The Ninth Circuit has held the same. *See Erdos v. SEC*, 742 F.2d 507, 508 (9th Cir. 1984) ("An NASD violation does not require that the dealer act with scienter."); *see also generally Alderman v. SEC*, 104 F.3d 285 (9th Cir. 1997). The J&E Rule's concern with unethical conduct is consistent with the NYSE rules' "special focus" on the "professionalization of the securities industry." *Gustafson v. Strangis*, 572 F. Supp. 1154, 1158 (D. Minn. 1983).

Despite this substantial authority, Petitioner points to our decision in *Buchman v. SEC*, 553 F.2d 816 (2d Cir. 1977), as well as SEC precedent stating that bad faith is required for a breach of contract to violate the J&E Rule. These cases are inapposite.

First, we should note that prior to our decision in *Buchman*, SEC precedent held that a breach of *contract* violated the J&E Rule when the breach "was unethical or dishonorable." *In the Matter of Samuel B. Franklin & Co.*, 38 S.E.C. 113, 1957 WL 52433, at *3 (Nov. 18, 1957); *see also In the Matter of the*

Application of S. Brokerage Co., Inc., 42 S.E.C. 449, 1964 WL 66923, at *3 (Nov. 19, 1964) ("But even if we were to assume that applicant were chargeable with a breach of its contract, it would not necessarily follow that it had violated the rule, for 'not every failure to perform a contract violates the NASD rule; it must also appear that such failure was unethical or dishonorable' or that the breach was committed 'without equitable excuse or justification.'" (footnote omitted)).

In 1977, this Court decided *Buchman*, in which we vacated an SEC order sanctioning a broker-dealer for violating NASD's J&E Rule. 553 F.2d at 818. The broker-dealer in *Buchman*, Shaskan & Co., Inc., refused to honor the terms of a purchase agreement with another broker-dealer for the sale of stock in a company called Crystalography. *Id.* The SEC had suspended trading in Crystalography's stock out of concern for fraud. *Id.* The SEC's rule at the time was that when it imposed such a suspension on trading, a broker could not complete contracts to accept delivery of the affected stock unless "he has *no* reason to believe" that the other party is connected with the fraudulent activity. *Id.* (emphasis added). While the SEC had lifted the suspension on Crystalography stock when the other broker-dealer attempted to deliver the stock in the company to Shaskan, the SEC issued a statement that "broker-dealers should take the necessary measures to assure themselves that they are not unknowingly effecting a consummation of open contracts which may be in furtherance of a scheme to manipulate the price of the securities of

Crystalography or would otherwise violate the Federal securities laws." *Id.* at 819. Shaskan requested clarification from the SEC as to its obligation to ensure that the other broker-dealer was not involved in fraud and refused to accept trades of the stock until it received such clarification. *Id.* In the meantime, Shaskan's capital position had become impaired, and the NYSE directed it to fulfill open contracts with its customers. *Id.* The firm never accepted the Crystalography shares, however, and NASD brought charges against it for failing to do so. *Id.* at 819-20. The SEC sustained NASD's finding that Shaskan and its principals did not "observe high standards of commercial honor and just and equitable principles of trade" when they refused to honor the contract. *Id.* at 820.

We vacated the SEC's order, writing:

> With deference to the Commission, we believe that under the circumstances of this case, Shaskan's refusal to complete the Muir transactions during and after the suspensions, was colorably justified by the confusion as to the true state of the market and as to the applicable law. By this we do not mean that Shaskan necessarily has a defense to a claim by Muir for breach of contract. But, as the Commission concedes, it is well-settled that "a breach of contract between NASD members is of no concern to the NASD or to the Commission if such breach does not contravene the ethical standards embodied in Article III, Section 1." The Commission

itself has held that a refusal to complete a contract based on a reasonable belief that a transaction was part of a manipulative scheme does not violate Article III, Section 1. There are, of course, situations in which this claim is a sham, and if it is found that "petitioner did not have a belief both honest and reasonable that there was a manipulative scheme afoot at the time of the contractual default," its failure to fulfill contractual obligations would violate Article III, Section 1. The touchstone, in other words, is good faith – the ultimate test of violation of an ethical standard. *A breach of contract is unethical conduct in violation of NASD Rules only if it is in bad faith*, just as conduct violates rule 10b-5 only if there is scienter: intent to deceive, manipulate or defraud. The measure of culpability then becomes whether appellants were in good faith.

Appellants here . . . were put on notice by the Commission itself that there had actually been unlawful manipulation of the price of Crystalography stock. And, as we have seen, the Commission itself notified the broker-dealers in the public release lifting the seven-month old suspension of trading, Release No. 10156, that there was a real possibility of a spill-over of the unlawful activity with respect to open contracts. The release warned brokers "to assure themselves that they are not unknowingly effecting a consummation of open contracts which may be in furtherance of a scheme to

manipulate the price of securities of Crystalography." . . . [T]here can be no doubt of appellants' bona fide belief "that there was a manipulative scheme afoot" and that, based upon the warning issued by the Commission after the suspension was lifted, the manipulative scheme still affected open contracts. This record does not support a conclusion that appellants were snatching excuses out of thin air. They were bound to cooperate with the Commission in refusing to accept stock which would succeed in bringing the fruits of manipulation to a guilty seller.

. . .

A broker, confronted with an atmosphere of manipulation or insider trading, faces a real dilemma. He risks a breach of contract action if he refuses to accept delivery, but he risks other sanctions if he accepts delivery in the face of publicly proclaimed suspicions of Securities Act violations which permeate the scene.

The evidence should be truly substantial to support a finding that, in such circumstances, when there is evident manipulation, the broker has wilfully used the situation in a fraudulent effort to avoid his contractual obligation. This is especially true when the alleged ethical misconduct is based on a single transaction and does not even purport to show a course of unethical business practice. We see nothing in our decision which

> would encourage truly unethical practices or would lower the standards of compliance.
>
> Accordingly, we grant the petition. The Commission order is vacated.

Id. at 820-21, 824 (emphasis added; internal citations and footnotes omitted).

Buchman is entirely distinguishable from this case. As the Chief Hearing Officer found in the present case, "[n]othing in the record would indicate that [Petitioner], in the instant matter, was under any competing obligation to make the disclosures that he did or that any 'equitable excuse' relieved him of his ethical obligation to keep the information confidential." *In the Matter of NYSE Disciplinary Proceedings Against Thomas W. Heath, III*, NYSE Hearing Bd. (Nov. 24, 2006), SPA 29; *see also supra* **[pp. 12-13]**. Specifically, the Chief Hearing Officer found that Petitioner acted for self-serving reasons, i.e., to build a relationship with Corrigan, and dismissed Petitioner's explanation that he made the disclosures in order to preempt Corrigan from "snooping" around the deal and acting on the information in the market place. She suggested that if Petitioner "suspected that Corrigan might 'snoop around the deal' for the purposes of 'acting on information in the market place,' [he] could have – and, indeed, should have – taken other steps to prevent such a result, such as alerting his current and future employers, as well as his client, to his suspicions." *In the Matter of Thomas W. Heath, III*, at SPA 29 n.4; *see also supra*

[pp. 12-13]. These findings, which the SEC affirmed and we conclude are supported by substantial evidence, demonstrate why *Buchman* is entirely inapposite to this case. That is, in *Buchman*, the petitioner Shaskan was faced with the opposing interests of the SEC's concern for fraud, expressed in a specific SEC warning, and Shaskan's contractual obligation to accept the Crystalography shares. Thus Shaskan's reason for the breach of contract, i.e., a good faith adherence to SEC warnings, became all important in understanding Shaskan's ethical obligation and its lack of bad faith in breaching the contract. Here, by contrast, Petitioner was faced with a different factual situation and no such competing ethical and regulatory considerations; he owed a fiduciary duty to Hibernia to keep the information confidential and he disclosed that information in violation of his ethical obligation to his client.

Moreover, the SEC has correctly understood *Buchman* to be limited to the breach of contract context. *See, e.g.*, *In the Matter of the Application of Morris E. Kurz*, 51 S.E.C. 1031, 1994 WL 91259, at *2 n.10 (Mar. 15, 1994) (breach of contract case, citing *Buchman*); *In the Matter of the Application of Robert J. Jautz*, 38 S.E.C. Docket 91, 1987 WL 757991, at *2 & n.4 (Apr. 15, 1987) (same); *In the Matter of the Application of William D. George, III*, 47 S.E.C. 368, 1980 WL 27420, at *2 & n.2 (Sept. 8, 1980) (same); *see also In the Matter of the Application of Leonard John Ialeggio*, 63 S.E.C. Docket 295, 1996 WL 632974, at *2 n.10 (Oct. 31, 1996) (citing *Buchman* as

holding that a "breach of contract violate[s] [the J&E Rule] where bad faith or unethical conduct evidenced'"). This is a breach of confidence case, which implicates quintessential ethical considerations not necessarily implicated in a breach of contract case. Thus, the axiom that the J&E Rule prohibits mere unethical conduct and does not require scienter holds true in this case.[7] At bottom, the only question is whether Petitioner's breach of confidence constitutes unethical conduct.[8]

Petitioner argues, however, that the bad faith standard articulated in *Buchman* has been applied outside the breach of contract context. He relies upon two SEC decisions: *In the Matter of the Application of Nicholas T. Avello*, Exchange Act Release No. 51,633, 2005 WL 1006827 (Apr. 29, 2005) ("*Avello*"), *aff'd*, *Avello v. SEC*, 454 F.3d 619 (7th Cir. 2006); and *In the Matter of the Application of Calvin David Fox*, 89

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[7] Petitioner makes much of the fact that the SEC has cited *Buchman* for two divergent propositions, i.e., that a breach of contract violates the J & E Rule if the breach was "committed in bad faith or is accompanied by unethical conduct," *see, e.g.*, *Jautz*, 1987 WL 757991, at *2 & n.4, and that such a breach violates the J&E Rule only if there is a finding of bad faith, *see George*, 1980 WL 27420, at *2 & n.2. To the extent that this precedent injects any ambiguity into the SEC's J&E Rule jurisprudence, it is limited to the breach of contract context and is therefore not relevant to this appeal.

[8] Although Petitioner does not specifically argue that the record contains insufficient evidence that he engaged in unethical conduct, as explained *infra* [p. 38], we hold that the evidence is overwhelming.

S.E.C. Docket 1156, 2006 WL 3455114 (Nov. 30, 2006) ("*Fox II*"), *aff'd*, *Fox v. SEC*, 275 F. App'x 1 (D.C. Cir. 2008), *cert. denied*, 129 S. Ct. 952 (2009).

In *Avello*, the petitioner appealed to the SEC after NASD found him liable for operating a securities business with insufficient net capital, failing to maintain accurate financial records, making inaccurate financial reports to NASD and filing six inaccurate quarterly reports. It was found that Avello was given incorrect information by a co-worker and did not act in bad faith. *Avello*, 2005 WL 1006827, at *1-3. The SEC wrote:

> Avello argues . . . that there is a requirement that NASD find there was bad faith before finding liability under NASD Conduct Rule 2110. When a violation of Conduct Rule 2110 is not based on the violation of some other rule, we have required a showing that the respondent has acted in bad faith before liability can be found.[FN8] There is no bad faith requirement, however, when, as here, a violation of Conduct Rule 2110 is based upon the violation of a Commission rule.

Id. at *3. Footnote 8 in *Avello* reads:

> *Robert J. Jautz*, 48 S.E.C. 702, 703-04 (1987) (if obligation to "observe high standards of commercial honor and just and equitable principles of trade" is only violation alleged, there must be a finding of bad faith).

Id. at *3 n.8.

First, it is clear that *Avello*'s statement regarding bad faith is *dictum* because the conduct at issue in that case violated a separate rule, which automatically amounts to a violation of the J&E Rule. Moreover, *Avello*'s citation to *Jautz* is inaccurate, as *Jautz* held that "a breach of contract violates [the J&E Rule] only if it is committed in bad faith *or is accompanied by unethical conduct.*" *Jautz*, 1987 WL 757991, at *2 (emphasis added).[9]

The same two problems lie with Petitioner's citation to the SEC's decision in *Fox II*, which was issued after the remand to the NYSE in *Fox I*, *see supra* **[pp. 21-22]**. As noted, the NYSE found that Fox violated the J&E Rule by making a misstatement to his member firm employer about the status of his license to practice law in the State of Florida and by submitting to his employer an altered copy of an order of the Florida Supreme Court to support the misstatement. *Fox I*, 81 S.E.C. Docket 1511, 2003 WL 22467374, at *1 (Oct. 31, 2003). Fox argued, however, that he had a good faith mistaken belief regarding

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[9] In *Jautz*, NASD brought charges against Jautz, who was a broker, for soliciting and obtaining a loan from a customer and then failing to repay it. *Jautz*, 1987 WL 757991, at *1-2. With respect to Jautz's solicitation of the loan from his customer, the SEC found that he did not violate the J&E Rule because he did not act unethically, as he did not take advantage of the customer in any way or make any misrepresentation. *Id.* at *2. With respect to Jautz's failure to pay the loan, the SEC found that he intended to make repayment "but was simply unable to do so." *Id.* The SEC concluded that the latter did not constitute bad faith or unethical conduct. *Id.*

the status of his license and that he accidentally sent the altered copy of the order to his employer. *Id.* at *2. In *Fox I*, the SEC, citing *Jautz*, "held that a self-regulatory organization need not find that the respondent acted with scienter, but must find that the respondent acted in bad faith or unethically." *Id.* at *3 & n.3. It noted, however, that "the NYSE did not make findings with respect to whether Fox acted in bad faith or unethically." *Id.* at *3. It remanded to the NYSE, which on remand found that Fox's conduct "was in bad faith *and* unethical." *Fox II*, 2006 WL 3455114, at *1. Fox then appealed to the SEC, but the SEC dismissed his appeal on the basis that it was untimely, and thus did not reach the merits. *See id.* at *1-2.

Petitioner hones in on a footnote in *Fox II*. The relevant text and footnote reads:

> In the remand decision, we asked the NYSE to address whether Fox's alleged conduct was in bad faith or unethical.[FN3]
>
> . . .
>
> FN3. *Cf. Robert J. Jautz*, 48 S.E.C. 702, 703-04 (1987) (holding that if only violation alleged by NASD is failure to observe just and equitable principles of trade, there must be a finding of bad faith).

Id. at *1 n.3. As with *Avello*, this is *dictum* and an incorrect recitation of the law as set forth in *Jautz*.

Under these circumstances, we agree with the SEC that the incorrect *dicta* in *Avello* and *Fox II* cannot reasonably be read as signaling a rejection of the SEC's longstanding "unethical conduct" standard for J&E Rule violations outside the breach of contract context. It is clear from the Exchange Act and the relevant SEC and circuit precedent that the J&E Rule prohibits mere unethical conduct in a breach of confidence case.

While we have reached this conclusion without affording dispositive deference to the NYSE or SEC, we acknowledge our obligation to afford some level of deference to their interpretation of the NYSE rules. *See Fogel v. Chestnutt*, 533 F.2d 731, 753 (2d Cir. 1975) (Friendly, *J.*) ("[A]n exchange has a substantial degree of power to interpret its own rules."), *cert. denied*, 429 U.S. 824 (1976); *accord Alderman v. SEC*, 104 F.3d 285, 288 (9th Cir. 1997); *Shultz v. SEC*, 614 F.2d 561, 571 (7th Cir. 1980) ("[B]ecause these are rules of the Exchange, the Exchange should be allowed discretion in determining their meaning. Here the Commission has affirmed that interpretation, and we find no error in its approval." (internal citations omitted)); *Intercontinental Indus., Inc. v. Am. Stock Exch.*, 452 F.2d 935, 940 (5th Cir. 1971) ("Since these are the rules of the Exchange, it should be allowed broad discretion in the determination of their meaning and application. We find no error in the Commission's approval of [this] interpretation of the rule."), *cert. denied*, 409 U.S. 842 (1972); *Moses v. Burgin*, 445 F.2d 369, 382 (1st Cir. 1971); *cf. Krull v.*

SEC, 248 F.3d 907, 911-12 (9th Cir. 2001); *Gurfel v. SEC*, 205 F.3d 400, 402 (D.C. Cir. 2000).

II. Notice Argument

Petitioner argues next that neither the NYSE nor the SEC has articulated a mental state standard for a J&E Rule violation. He contends that without an articulation of a mental state standard, registered members lack "fair notice of the conduct that might be sanctioned." Brief for Petitioner Thomas W. Heath III at 30. He writes, "[E]ven if [Petitioner] knew that he would be held to certain professional standards, he was still entitled to more specific guidance as to the NYSE's interpretation of the J&E Rule; there was no way of knowing in advance what kind of errors – non-negligent, innocent mistakes or isolated, serious deviations – as to the duty of confidentiality would violate the J&E Rule." *Id.* at 38 (internal quotation marks and alterations omitted).

Petitioner's reliance on *Checkosky v. SEC*, 23 F.3d 452 (D.C. Cir. 1994) ("*Checkosky I*"), and its progeny, *Checkosky v. SEC*, 139 F.3d 221 (D.C. Cir. 1998) ("*Checkosky II*") and *Marrie v. SEC*, 374 F.3d 1196 (D.C. Cir. 2004), is misplaced. There the SEC failed to articulate the required mental state for a violation of the rule at issue (even after being instructed to do so by the D.C. Circuit). The D.C. Circuit wrote:

> Not only does the opinion on remand provide no clear mental state standard to govern

> Rule 2(e)(1)(ii), it seems at times almost deliberately obscurantist on the question. . . . In summary, the Commission's opinion yields no clear and coherent standard for violations of Rule 2(e)(1)(ii). Although we owe substantial deference to an agency's interpretation of its own regulations, we cannot defer to an agency when we are at a loss to know what kind of standard it is applying or how it is applying that standard to this record.

Checkosky II, 139 F.3d at 225 (internal quotation marks and citations omitted).

Here, by contrast, the SEC has made clear that no scienter is required and mere unethical conduct is sufficient outside the breach of contract context. Further, the SEC has made clear that industry norms and fiduciary standards are determinative as to what constitutes unethical conduct. *See, e.g.*, *In the Matter of the Application of Leonard John Ialeggio*, 63 S.E.C. Docket 295, 1996 WL 632974, at *3 (Oct. 31, 1996) (looking to "the fiduciary standards demanded of registered persons in the securities industry"); *In the Matter of the Application of E.F. Hutton & Co. Inc.*, 41 S.E.C. Docket 413, 1988 WL 901859, at *2 (July 6, 1988) ("Our aim is to give effect to the reasonable expectations of the parties to the relationship. Where there is no explicit agreement to the contrary and the relationship is a fiduciary one, the law governing fiduciary duties provides presumptive definition for such expectations."); *In the Matter of Samuel B. Franklin & Co.*, 38 S.E.C. 113, 1957 WL 52433, at *3 (Nov. 18, 1957) ("The Rule states a broad ethical

principle and the question presented thereunder is whether the member's conduct in question violates standards of fair dealing."). Thus, while the lack of a scienter requirement may make for a more flexible rule, we are not presented with the same obstacle as the D.C. Circuit faced in *Checkosky I* and its progeny.

Moreover, the J&E Rule's standard of unethical conduct does not fail to provide Petitioner with adequate notice that the conduct in question was sanctionable. As we explained in *Perez v. Hoblock*, 368 F.3d 166 (2d Cir. 2004):

> The Due Process Clause requires that laws be crafted with sufficient clarity to give the person of ordinary intelligence a reasonable opportunity to know what is prohibited and to provide explicit standards for those who apply them. . . . [T]he Supreme Court has expressed greater tolerance of enactments with civil rather than criminal penalties because the consequences of imprecision are qualitatively less severe.
>
> The evaluation of whether [the law at issue] is vague as applied to [appellant] must be made with respect to [his] actual conduct and not with respect to hypothetical situations at the periphery of the [regulation's] scope or with respect to the conduct of other parties who might not be forewarned by the broad language. Thus, although the prohibition [here] . . . is admittedly flexible, and officials implementing this standard will undoubtedly exercise some discretion in

> interpreting and applying the regulation, our primary focus must be on whether the specific conduct at issue in this case falls with sufficient clarity within the ambit of the regulation. . . .
>
> In evaluating [appellant's] vagueness claim, we must consider the context in which the regulation was enforced, i.e., we must evaluate [his] underlying conduct by reference to the norms of the racing community.

Id. at 174-76 (internal quotation marks, citations and footnote omitted).

Applying these principles, we rejected the very argument that Petitioner is making here in *Crimmins v. Am. Stock Exch., Inc.*, 503 F.2d 560 (2d Cir. 1974) (*per curiam*), wherein we adopted the district court's decision, which stated:

> Plaintiff next contends that the Exchange rule barring conduct in breach of "just and equitable principles of trade" is unconstitutionally vague because the Exchange has never adopted rules specifying the prohibited acts. The contention is without merit. As an experienced registered representative, plaintiff may be fairly charged with knowledge of the ethical standards of his profession, especially where the conduct proscribed involves so central a principle as the avoidance of clear conflicts of interest. We find that, as applied to plaintiff, the Exchange's standard is not impermissibly vague, and that he lacks standing to attack the Exchange standard on

> the ground that it might be unconstitutional as applied to others.

Crimmins v. Am. Stock Exch., Inc., 368 F. Supp. 270, 277 (S.D.N.Y. 1973); *see also Rooms v. SEC*, 444 F.3d 1208, 1214 (10th Cir. 2006) ("[A]ny reasonable person would know that this type of intentional deception of the NASD would violate [its J&E Rule] requirement that the person's conduct conform to high standards of commercial honor and just and equitable principles of trade. Mr. Rooms had been a registered representative in the securities industry since 1991. Based on those years of experience, he certainly knew that bribery and backdating and altering documents are not ethical and accepted conduct in the securities industry. Because Mr. Rooms had fair notice that his conduct was contrary to Rule 2110, we reject his due process argument." (internal citations omitted)); *Sorrell v. SEC*, 679 F.2d 1323, 1326 (9th Cir. 1982) ("Evaluating his vagueness claim in the context of his violation, selling unregistered securities, we find Sorrell had adequate notice that such an obvious violation of the securities laws also would violate [NASD's J&E Rule].").

Thus, Petitioner's notice argument is without merit. While it may be true that Petitioner's conduct is not as egregious as that of others who have been sanctioned by the NYSE, the SEC was correct in concluding that any reasonably prudent securities professional would recognize that the disclosure of confidential client information under the circumstances of this case constitutes unethical conduct

sanctionable under the J&E Rule. As the SEC explained in its Opinion:

> As an experienced investment banker, [Petitioner] can be fairly charged with notice that his breach of his duty to maintain the confidentiality of his client's information violated the just and equitable principles of trade. Any reasonably prudent securities professional would recognize that the disclosure of confidential client information violates the ethical norms of the industry. . . . [Petitioner]'s position is further undercut by the express restrictions on the use of client information in the [J.P. Morgan] Code of Conduct.

In the Matter of the Application of Thomas W. Heath, III, Release No. 59,223, 94 S.E.C. Docket 3466, 2009 WL 56755 (Jan. 9, 2009). Accordingly, we reject Petitioner's argument that he did not have adequate notice under the J&E Rule.

III. Summary Judgment Argument

Finally, Petitioner argues that the NYSE Chief Hearing Officer erred in granting summary judgment on the issue of guilt. First, he contends that "a determination of guilty by summary judgment denies a respondent a chance to truly test Enforcement's case" because his ability to compel discovery and engage in cross-examination is limited. Brief for Petitioner Thomas W. Heath III at 44. But Petitioner fails to recognize that the record was fully developed

at the penalty phase of the NYSE proceedings and the SEC thoroughly reviewed that record de novo. *See supra* **[pp. 13-14]**. In fact, Petitioner fails to point to any evidence that he was precluded from submitting during the NYSE proceedings and SEC appeal.[10]

Petitioner further argues that the Chief Hearing Officer failed to resolve questions of fact and draw reasonable inferences in his favor in violation of the summary judgment standard. In particular, he asserts that the Chief Hearing Officer failed to weigh in his favor: (i) Howard's statement that he (as a Hibernia officer and director at the time of the disclosure) did not consider Petitioner's conduct to be unethical or in breach of his trust; and (ii) Petitioner's testimony that he believed it was in his client's interest to make the disclosure in order to prevent Corrigan from "snooping around" the deal. Petitioner argues that "Howard's statement and [his own] testimony should have given rise to inferences that [Petitioner] was authorized to make the disclosure and was actively attempting to protect Hibernia's

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[10] At oral argument, Petitioner claimed that, if now allowed an opportunity to do so, he would submit expert testimony regarding whether his disclosure of confidential information violated ethical norms in the industry. But he never made any attempt to offer such evidence at the summary judgment or penalty phase, and indeed moved for summary judgment on the then record. We believe that the record was sufficiently developed on this issue, and that both the NYSE and the SEC adequately considered Petitioner's argument in this regard.

interest." Brief for Petitioner Thomas W. Heath III at 47.

This argument ignores the fact that the record was fully developed as to these facts at the penalty phase of the NYSE proceeding, and that the SEC carefully considered that record on appeal in connection with Petitioner's assertion that he was acting in the best interests of Hibernia. With respect to Howard's testimony, the SEC found:

> [T]his former officer testified in his individual capacity, and the record suggests that he was not aware of the disclosure until after it had been made. [Petitioner]'s duty of confidentiality was owed to Hibernia as his investment banking client – not to any individual Hibernia officer or director. At the time of [Petitioner]'s conversation with Corrigan, [Petitioner] did not have general authorization to disclose information about the merger except on a need-to-know basis. In the absence of express prior authorization from his client and in accordance with the Code of Conduct, [Petitioner] remained bound by his obligation to safeguard information about the acquisition solely for Hibernia's interest.

In the Matter of the Application of Thomas W. Heath, III, 2009 WL 56755, at *9. With respect to Petitioner's own testimony, the SEC found:

> [Petitioner] further claims . . . that he . . . was actively attempting [ ] to protect Hibernia's interest by making the disclosure to

> freeze out Mr. Corrigan. However, [Petitioner]'s decision to divulge unquestionably confidential information was not justified on this basis. The record does not indicate that [Petitioner] could have reasonably believed that Corrigan was in a position to threaten the transaction, or that detailed disclosure was otherwise necessary to protect Hibernia's interests. The transaction had not been publicly announced and Corrigan had not indicated that he had access to any information sufficient to jeopardize the acquisition. When Corrigan referenced "rumors in the marketplace" about "a bank deal somewhere in the south," the reasonable course of action for protecting Hibernia's interest was to decline to discuss the transaction. Instead, [Petitioner] chose to divulge highly sensitive information about the critical terms of the transaction.

Id. (internal quotation marks omitted). These findings are drawn from a fully developed record and are supported by substantial evidence.

Finally, because the SEC conducted a thorough, de novo review of the record, any procedural errors that may have been committed by the Chief Hearing Officer are cured. *See McCarthy v. SEC*, 406 F.3d 179, 187 (2d Cir. 2005) ("The Commission independently evaluated the extensive factual record developed by the Hearing Panel and the Board and provided a lengthy analysis of McCarthy's case, ultimately reaching a reasoned decision upholding the Board's decision. There is thus no need for us to review the

lack of reasons for the Board's decision, because the due process afforded McCarthy before the Commission cured any alleged defect."); *R.H. Johnson & Co. v. SEC*, 198 F.2d 690, 695 (2d Cir. 1952) ("We conclude that we may consider any errors in the proceedings of [NASD] only if and to the extent that they infected the Commission's action by leading to errors on its part.").

CONCLUSION

For the foregoing reasons, we DENY the Petition.

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 59223 / January 9, 2009

Admin. Proc. File No. 3-12890

In the Matter of the Application of

THOMAS W. HEATH, III
c/o Gary P. Naftalis
Kramer Levin Naftalis & Frankel LLP
1177 Avenue of the Americas
New York, New York 10036

For Review of Disciplinary Action Taken by

NYSE REGULATION, INC.

OPINION OF THE COMMISSION

NATIONAL SECURITIES EXCHANGE – REVIEW OF DISCIPLINARY PROCEEDING

Conduct Inconsistent with Just and Equitable Principles of Trade

Former registered representative of member firm of national securities exchange alleged to have engaged in conduct inconsistent with just and equitable principles of trade by disclosing material non-public information. Held, exchange's findings of violation and imposition of sanctions are sustained.

APPEARANCES:

Gary P. Naftalis, Alan R. Friedman, Michael S. Oberman, and Joel M. Taylor, of Kramer Levin Naftalis & Frankel LLP, for Thomas W. Heath, III.

Linda Riefberg, Martin Mazur, Allen Boyer, Kathleen Lynch, and David Camuzo, for Financial Industry Regulatory Authority, Inc., Department of Enforcement, on behalf of NYSE Regulation, Inc.

Appeal filed: November 15, 2007
Last brief received: February 22, 2008

I.

Thomas W. Heath, III, a former registered representative of New York Stock Exchange, LLC ("NYSE" or the "Exchange") member firm J.P. Morgan Securities Inc. ("JPMorgan"), appeals from NYSE disciplinary action.[1] The Exchange found that Heath

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[1] On July 26, 2007, the Commission approved proposed rule changes in connection with the consolidation of the member firm regulatory functions of the National Association of Securities Dealers ("NASD") and NYSE Regulation, Inc. See Securities Exchange Act Rel. No. 56146 (July 26, 2007), 91 SEC Docket 517. Pursuant to this consolidation, the member firm regulatory and enforcement functions and employees of NYSE Regulation, Inc. were transferred to NASD, and the expanded NASD changed its name to Financial Industry Regulatory Authority, Inc. See Exchange Act Rel. No. 56148 (July 26, 2007), 91 SEC Docket 522. Because the disciplinary action here was taken before the NYSE-NASD consolidation of regulatory operations, we continue to use the designation "NYSE" in this opinion.

disclosed material non-public information regarding the pending acquisition of a JPMorgan client, and that such disclosure constituted "conduct . . . inconsistent with just and equitable principles of trade" in violation of NYSE Rule 476(a)(6). The NYSE censured Heath and imposed a $100,000 fine. This appeal followed. We base our findings on an independent review of the record.

II.

At the time of the disclosure, Heath was an investment banker and managing director at JPMorgan, but was planning his imminent departure from JPMorgan to begin a new position as a managing director and group head at Banc of America Securities LLC ("BofA"). In early 2005, Tony Ursano, Jr., Global Head of BofA's Financial Institutions Group, began recruiting Heath to head BofA's bank group. After interviews with several senior BofA executive officers, in mid-February Heath was offered and orally accepted a position as BofA's "Head of Banks." In accepting the BofA offer, Heath informed Ursano that he was committed to completing a transaction at JPMorgan before starting the new position at BofA.

While Heath was having these discussions with BofA, JPMorgan had been advising Hibernia Bank ("Hibernia") in connection with its proposed acquisition by Capital One Corp. ("Capital One"). Heath was JPMorgan's "client executive" in charge of the Hibernia account, with primary responsibility for securing

and managing JPMorgan's role as Hibernia's lead advisor and primary investment banking representative in connection with the transaction.

After accepting the BofA offer, Heath informed his JPMorgan supervisor of his impending move, but stated his intention to "get [JPMorgan] engaged on Hibernia and get the deal across the finish line" before resigning.[2] Heath completed his pre-hire paperwork for BofA on February 16, 2005, and received a draft of an offer letter from BofA on February 25, 2005. During this period, Heath continued to work at JPMorgan on the Hibernia acquisition.

Prior to Heath's start at BofA and five days before the public announcement of the Hibernia deal, Ursano asked Heath to call Eric Corrigan, the then-head of BofA's depository institutions group. Heath and Corrigan's conversation was potentially sensitive because Corrigan had recently been "very disappointed" and "upset" to learn that Heath would be heading the bank group, when Corrigan may have previously thought that they would be co-heads of the bank group. Ursano urged Heath to "let [Corrigan] know you're fair . . . you're going to be a good partner with him . . . you're not going to stomp all over him . . . [and] talk about the business plan going forward."

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[2] Heath points out that he had no monetary stake in completing the acquisition at JPMorgan because he would forfeit any deal-based bonus by resigning prior to fiscal year end. He testified that he was trying to do "the right thing" by delaying his move rather than disrupting the deal.

When Heath and Corrigan spoke the next day, the two discussed overlapping client accounts and changes in the banking landscape. Near the end of the conversation, Corrigan inquired about Heath's then-current project, stating: "there are a lot of rumors out in the marketplace. And [we] . . . know you have a bank deal somewhere down in the south." Heath testified that he initially demurred, but when Corrigan persisted, he eventually responded: "if you really want to know, I will tell you exactly what it is, but you have to understand, you know, I've got a week to go. This is obviously confidential information. The deal is done, bankers have been hired, nothing is going to change. And you just have to understand and respect that," and stipulated that Corrigan could not "act on this in any way."

After Corrigan agreed to keep the information confidential, Heath described the Hibernia acquisition in detail, describing the parties, JPMorgan's role, the percentage of cash consideration, and the rationale for the stock consideration. Heath testified that he was trying to make it clear that the terms and advisors had already been finalized, and thereby protect his client by preempting any efforts by BofA to solicit business in the transaction. By eliciting Corrigan's promise of confidentiality, Heath testified that he believed that he had "put a firewall around the problem." He also testified that he felt that he was "dealing with someone who's going to be a colleague" and "the whole purpose of this [conversation] is to build trust and -- and build a collegiality with."

Despite his agreement to keep the information confidential, that same day Corrigan discussed the acquisition with Tom Chen, the head of BofA's diversified financial services group. Corrigan and Chen discussed contacting Capital One in an attempt to participate in the transaction -- the result that Heath states that he was trying to preempt. Chen left a voicemail message with Capital One that evening indicating his awareness of a "bank deal" and asking to get involved. Chen's message was not returned. On March 3, while Heath was hosting meetings at his future BofA office and before the acquisition was announced, Corrigan approached him to ask if "there [was] room for other advisors" on the transaction. Heath responded "don't even go there . . . I can't believe you're even saying that."

The Hibernia acquisition was publicly announced on March 6, 2005. That same day the Chairman of JPMorgan's North American Mergers and Acquisitions group called Heath and told him that BofA had called Capital One attempting to get hired with the "name, price, structure, timing" of the transaction. Heath was told that he had been identified as the source of the leak, and that JPMorgan was placing him on leave.

On March 8, Heath briefed Ursano on his disclosure to Corrigan and his understanding of the subsequent course of events. Heath testified that he requested that Ursano "elevate [the issue] internally to the top of the house immediately." The next day, BofA began an investigation. On March 15, 2005,

after interviewing Heath, Chen, Corrigan, and Ursano as part of its internal investigation, BofA revoked Heath's employment offer, and terminated Chen and Corrigan. JPMorgan had previously terminated Heath's employment on March 14, 2005.

III.

On January 25, 2006, the NYSE Division of Enforcement (the "Division") charged that Heath's disclosure violated NYSE Rule 476(a)(6) prohibiting conduct inconsistent with just and equitable principles of trade (the "J&E Rule"). On November 24, 2006, the Chief Hearing Officer of the NYSE Hearing Panel issued an order (the "Summary Judgment Order") granting summary judgment to the Division on the issue of liability, concluding that Heath had violated the J&E Rule.[3] The Summary Judgment Order held that a "violation of the just and equitable principles of trade codified by NYSE Rule 476(a)(6) may occur either through bad faith or unethical conduct." (emphasis in original)

The Summary Judgment Order held that Heath's disclosure was unethical, finding that Heath violated his duty to maintain the confidentiality of material nonpublic information. The order traced the duty of

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[3] The hearing officer granted summary judgment under NYSE Rule 476(c), which authorizes the hearing officer to "resolve any and all procedural and evidentiary matters and substantive legal motions."

confidentiality to prohibitions on the disclosure of confidential client information in the JPMorgan Code of Conduct (the "Code of Conduct") and to agency law principles, citing "the ethical obligation to which every financial advisor becomes subject upon learning of sensitive, nonpublic information about a client." The order found that Heath's "reasons for making the disclosures -- while certainly lacking any malevolent or deceitful quality -- were, in the final analysis, self-serving in that they were intended to gain the trust of, and thereby smooth things over with, a soon-to-be colleague."

The NYSE Hearing Panel then held a hearing to determine sanctions, taking testimony from Heath and from the JPMorgan executive that had suspended Heath.[4] On March 15, 2007, the panel imposed a censure and $100,000 fine. On October 17, 2007, the NYSE Board of Directors affirmed the Summary Judgment Order and the Hearing Panel decision, stating that a J&E Rule violation "may be established by a finding of either bad faith or unethical conduct." This appeal followed.

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[4] The panel also heard testimony in Heath's defense from the former general counsel at JPMorgan, and from a former officer and member of the Hibernia board of directors that had approved the acquisition.

IV.

We agree with the Exchange's finding that Heath's disclosure constituted unethical conduct in violation of the J&E Rule. In disclosing confidential client information, Heath violated one of the most fundamental ethical standards in the securities industry. The duty to maintain the confidentiality of client information is grounded in fundamental fiduciary principles,[5] and is further codified in the Code of Conduct. The Code of Conduct expressly prohibits the disclosure of confidential information "to anyone outside the firm unless . . . authorized to do so," and instructs that, even when disclosure is permitted, employees should "use [their] judgment to limit the amount of information shared and disclose it only on a need-to know basis."[6] The Code of Conduct also states that this obligation to maintain client confidentiality continues after the termination of employment with the firm.[7]

We find that Heath's disclosure was ultimately self-interested and for his, not his principal's, purposes.

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[5] See Restatement (Third) of Agency §8.05 (setting forth an agent's duty "not to use or communicate confidential information of the principal for the agent's own purposes or those of a third party"); see also Jonathan Feins, 54 S.E.C. 366, 372 (1999) (holding that "[a]s agent, [applicant] was obligated to act solely for his customer's benefit, and in his customer's best interests, in completing the transaction").

[6] JPMorganChase Code of Conduct § 3.1 (November 2004).

[7] Id. at § 5.11.

As Heath testified, "the whole purpose" of his conversation with Corrigan was "to build trust and -- and build . . . collegiality." We concur with the NYSE Hearing Panel's finding that Heath's disclosure "was motivated by a desire to gain the trust of a future colleague."

Heath does not deny that he disclosed material non-public information regarding the Hibernia acquisition. Instead, he contends that his disclosure did not violate the J&E Rule because he was not found to have acted in bad faith. Heath argues that a violation of the J&E Rule must be based on either a finding of bad faith or the violation of another rule or regulation.[8] In the alternative, he argues that he had not received "fair notice" that bad faith is not the standard for J&E Rule liability, and that he had not received notice of the specific state of mind finding required to sustain disciplinary action under the rule. Heath further asserts that "[e]ven if the Commission were to accept the [Exchange's] formulation of 'unethical conduct as something broader than bad faith,'" Heath's actions, when considered in light of all of the surrounding circumstances, do not satisfy

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[8] It is well-established that a violation of another self-regulatory organization ("SRO") or Commission rule or regulation will also automatically constitute a violation of the J&E Rule. See, e.g., Stephen G. Gluckman, 54 S.E.C. 175, 185 (1999) (noting the Commission's "long-standing and judicially-recognized policy that a violation of another Commission or NASD rule or regulation . . . constitutes a violation of" the NASD rule regarding just and equitable principles of trade).

that standard. Finally, Heath contends that the Exchange's liability finding should be reversed because the issue was improperly decided by an individual hearing officer acting on a motion for summary judgment. We reject these contentions for the reasons outlined below.

A. Standard for J&E Rule Violation

Heath argues that liability under the J&E Rule must be premised on a bad faith finding. As the Exchange points out, however, we have long applied a disjunctive "bad faith or unethical conduct" standard to disciplinary action under the J&E Rule.[9] This rule incorporates "broad ethical principles,"[10] and focuses on the "ethical implications of the [a]pplicant's

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[9] See, e.g., Robert E. Kauffman, 51 S.E.C. 838, 839 n.5 (1993) ("The most that is required [for a finding of liability under the J&E Rule] is a finding of bad faith or unethical conduct."), aff'd, 40 F.3d 1240 (3d Cir. 1994) (Table); Chris Dinh Hartley, 57 S.E.C. 767, 773 n.13 (2004) ("If no other rule has been violated, a violation of [the J&E Rule] requires evidence that the respondent acted in bad faith or unethically.").

[10] Peter Martin Toczek, 51 S.E.C. 781, 788 n.14 (1993); Kauffman, 51 S.E.C. at 839 n.5; William F. Rembert, 51 S.E.C. 825, 826 n.3 (1993); Jay Frederick Keeton, 50 S.E.C. 1128, 1134 (1992); see also Larry Ira Klein, 52 S.E.C. 1030, 1031-32 (1996) (stating that the J&E Rule "sets out in broad terms the ethical standard against which the conduct of securities professionals is measured").

conduct."[11] The rule serves as an industry backstop for the representation "inherent in the relationship," between a securities professional and a customer, "that the customer will be dealt with fairly, and in accordance with the standards of the profession."[12]

Promulgated to discipline "a wide variety of conduct that may operate as an injustice to investors or other participants in the marketplace,"[13] the J&E Rule focuses on the securities professional's conduct rather than on a subjective inquiry into the professional's intent or state of mind.[14] Accordingly, a

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[11] Timothy L. Burkes, 51 S.E.C. 356, 360 (1993), aff'd, 29 F.3d 630 (9th Cir. 1994) (Table); Ben B. Reuben, 46 S.E.C. 719, 722 n.7 (1976).

[12] Atlanta-One, Inc., 52 S.E.C. 161, 163-64 (1995) (citing Duker & Duker, 6 S.E.C. 386, 388-89 (1939)), aff'd, 100 F.3d 105 (9th Cir. 1996); see also C. Brock Lippitt & Thomas M. Svalberg, 48 S.E.C. 524, 526 (1986) (sustaining a violation of the rule when "applicants frustrated the legitimate expectations of investors"), aff'd, 876 F.2d 181 (D.C. Cir. 1989); Leonard H. Zigman, 40 S.E.C. 954, 956 (1962) (finding applicant's actions exhibited "an attitude not consistent with the pervasive duty of fair dealing imposed upon those in the securities business").

[13] Daniel Joseph Alderman, 52 S.E.C. 366, 369 (1995) (holding that the deliberate withholding of payments due to clients for over two months violated the J&E Rule), aff'd, 104 F.3d 285 (9th Cir. 1997).

[14] Leonard John Ialeggio, 52 S.E.C. 1085, 1089 (1996) ("By [his] conduct, Ialeggio acted at least unethically, and thus violated" the J&E Rule), aff'd, 185 F.3d 867 (9th Cir. 1999) (Table); see also Svalberg v. SEC, 876 F.2d 181, 184 (D.C. Cir. 1989) (per curiam) (stating that "knowledge of what one is doing and the consequences of those actions suffices" to sustain a violation of the J&E Rule, and that the disciplinary action did not need to be

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violation of the rule need not be premised on a motive or scienter finding.[15] For instance, when most recently confronted with another applicant that, like Heath, appealed an SRO disciplinary decision under the J&E Rule based on a state of mind defense, we explicitly reaffirmed our long-standing view that the rule applies to either conduct committed in bad faith or conduct violating ethical standards.[16]

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based on a finding "that the subject believed his action to be illegal" (internal citation omitted)).

[15] See Shultz v. SEC, 614 F.2d 561, 570 n.20 (7th Cir. 1980) (declining to reach motive of market maker who violated the J&E Rule when he engaged in transactions "without legitimate economic purpose"); Keith Springer, 55 S.E.C. 632, 646 (2002) ("We need not ascertain Springer's motive in order to find that he committed the violations charged."); Ernest A. Cipriani, Jr., 51 S.E.C. 1004, 1006 n.8 (1994) ("[T]he NASD is not required to demonstrate motive to prove a violation of [the J&E Rule]."); Kenneth Sonken, 48 S.E.C. 832, 836 (1987) (stating that "it is unnecessary to determine the motivation for Sonken's action in order to conclude that tampering with the price of an option series violates just and equitable principles of trade"); Eliezer Gurfel, 54 S.E.C. 56, 63 (1999) ("Proof of scienter is not required to establish a violation of NASD [J&E Rule]."), petition denied, 205 F.3d 400 (D.C. Cir. 2000); Louis Feldman, 52 S.E.C. 19, 21 (1994) ("Scienter is not an element of the [J&E Rule] violation here."). Although Heath suggests that the J&R Rule holdings in these cases were contingent on the violations of other rules and regulations, the J&E Rule was the only rule found to have been violated in Gurfel and Feldman, and the J&E Rule violation in Springer was determined independent of any other rule violation.

[16] Calvin David Fox, 56 S.E.C. 1371, 1377 (2003) (remanding to the Exchange to "expressly consider whether Fox acted in bad faith or unethically").

As noted, Heath's breach of confidentiality violated one of the most basic duties of a securities professional, a duty that is grounded in fiduciary principles and reflected in the Code of Conduct. This conduct was properly subject to discipline under the J&E Rule. We have repeatedly held that the breach of a security professional's duty to a client is sufficient to sustain a J&E Rule violation. For example, in E.F. Hutton & Company Inc.,[17] and Bateman Eichler, Hill Richards, Inc.,[18] we found that applicants violated the rule based on findings that they violated fiduciary duties by engaging in transactions that created conflicts of interest with their customers' trading. These decisions were grounded in fiduciary principles requiring industry professionals to prioritize the interests of clients above their own interests, not in subjective state of mind findings.[19] Fiduciary principles have consistently driven the analysis in other cases

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[17] 49 S.E.C. 829, 833 (1988) (finding that a firm violated the rule in failing to execute a customer's limit order while simultaneously selling shares of the same security for its own account at a price higher than the customer's limit price).

[18] 47 S.E.C. 1025, 1026, 1028 n.7 (1984) (finding that a firm violated the rule in failing to execute customer market orders "fully and promptly, to the greatest extent possible," and allocating shares to its own short position before customer orders), aff'd, 757 F.2d 1066 (9th Cir. 1985).

[19] See Hutton, 49 S.E.C. at 832 ("Our aim is to give effect to the reasonable expectations of the parties to the relationship. Where there is no explicit agreement to the contrary and the relationship is a fiduciary one, the law governing fiduciary duties provides presumptive definition for such expectations.").

finding unethical conduct under the rule.[20] Moreover, we have looked to internal firm compliance policies to inform our determination of whether applicants' conduct, like Heath's, violated the professional standards of ethics covered by the J&E Rule.[21]

Heath relies on Buchman v. SEC,[22] for the proposition that bad faith is a required element of any violation of the J&E Rule, but Buchman is distinguishable. The Buchman court stated that "a breach of contract between [SRO] members is of no concern

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[20] Feldman, 52 S.E.C. at 22 (finding the rule was violated even when there was "no specific NASD rule addressing" the applicant's transfer of customer accounts to a new firm without prior consent because "under fundamental principles of agency law such prior consent is required"); see also Ialeggio, 52 S.E.C. at 1089 (submission of improper expense reimbursement request "cast doubt on [applicant's] commitment to the fiduciary standards demanded of registered persons in the securities industry and thus properly are the subject of NASD disciplinary action"); Joseph H. O'Brien, II, 51 S.E.C. 1112, 1115 (1994) ("It is well established that a securities firm has a fiduciary obligation to its customers and to the assets the customers entrust to that firm."); Daniel D. Manoff, 55 S.E.C. 1155, 1163 (2002) (finding that the unauthorized use of a customer's credit card violated the J&E Rule based on a finding that respondent breached his fiduciary duties).

[21] Dan Adlai Druz, 52 S.E.C. 416, 425 (1995) (finding that the respondent violated the J&E Rule by settling customer complaints without notifying the legal department when such action violated firm policy), aff'd, 103 F.3d 112 (D.C. Cir. 1996) (Table); Thomas P. Garrity, 48 S.E.C. 880, 884 (1987) (finding that failure to adhere to limits on trading of options under the firm's compliance policy violated the J&E Rule).

[22] 553 F.2d 816 (2d Cir. 1977).

to the [SRO] or to the Commission if such breach does not contravene the ethical standards embodied in" the J&E Rule,[23] and cited the "well-settled" proposition that a "breach of contract is unethical conduct in violation of NASD Rules, only if it is in bad faith, just as conduct violates rule 10b-5 only if there is scienter. . . ."[24] It concluded that the failure to deliver stock under a stock sale contract did not violate the J&E Rule when the breach was "colorably justified by the confusion as to the true state of the market and as to the applicable law."[25] The Buchman court cited good faith as the "touchstone" and "measure of culpability," for determining whether a breach of contract was justified or whether the breach constituted unethical conduct under the J&E Rule.[26] Although the court focused on bad faith as a prerequisite to liability, the court's analysis was grounded in the contractual context of that case. The decision was consistent with long-standing Commission precedent holding that a breach of contract alone is not automatically unethical conduct in violation of the rule, but that such breach may constitute a violation if it was "unethical or dishonorable" or "without equitable excuse or justification."[27] Following the Buchman

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[23] Id. at 820.

[24] Buchman, 553 F.2d at 821.

[25] Id. at 820.

[26] Id. at 821.

[27] See, e.g., Samuel B. Franklin & Co., 38 S.E.C. 113, 116 (1957) ("But not every failure to perform a contract violates the NASD rule; it must also appear that such failure was unethical

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decision, we have continued to focus on bad faith to determine whether a breach of contract, in and of itself, constitutes a violation of the J&E Rule.[28] As noted above, however, bad faith is not the sole standard, and state of mind findings have not been required, for finding liability under the rule in cases not premised on a breach of contract.

Heath argues that we adopted a general bad faith standard for J&E Rule liability in Nicholas T. Avello,[29] and in the Commission order in Calvin David Fox.[30] However, the language Heath cites in both instances was dicta and did not reflect a rejection or modification of established J&E Rule precedent. In

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or dishonorable."); Southern Brokerage Co., 42 S.E.C. 449, 453 (1964) ("[I]t is not our function nor that of the NASD under this rule to adjudicate private contract disputes. . . . 'not every failure to perform a contract violates the NASD rule; it must also appear that such failure was unethical or dishonorable' or that the breach was committed 'without equitable excuse or justification.' " (citations omitted)).

[28] See William D. George, 47 S.E.C. 368, 369-70 (1980) (stating that failure to comply with the terms of an indemnification contract did "not constitute a breach of the NASD's ethical standards unless it appears that [applicant] acted in bad faith"); Robert J. Jautz, 48 S.E.C. 702, 704 (1987) ("[I]t is well established that a breach of contract violates NASD standards only if it is committed in bad faith or is accompanied by unethical conduct.").

[29] Exchange Act Rel. No. 51633 (Apr. 29, 2005), 85 SEC Docket 1299, petition dismissed, 454 F.3d 619 (7th Cir. 2006).

[30] Exchange Act Rel. No. 54840 (Nov. 30, 2006), 89 SEC Docket 1282, aff'd, 2008 U.S. App. LEXIS 6647 (D.C. Cir. 2008) (per curiam).

Avello, we rejected the applicant's good faith defense because the J&E Rule violation in that case was based on recordkeeping and reporting rule violations.[31] Although the opinion states in dicta that "we have required a showing that the respondent has acted in bad faith before liability can be found" in the absence of another rule violation,[32] the J&E Rule violation in Avello was in fact based on underlying rule violations.

Heath similarly relies on a footnoted parenthetical in the Fox order that alludes to a bad faith measure of liability under the rule.[33] Our decision in that case, however, dismissed the appeal of a NYSE decision based on his late filing of the appeal before the NYSE Board of Directors -- not based on the standard for determining a violation of the rule. We noted that the underlying NYSE hearing panel decision had found

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[31] See supra note 8.

[32] In response to Avello's argument that he could not be found liable because he did not act in bad faith, the opinion stated "[w]hen a violation of [the J&E Rule] is not based on the violation of some other rule, we have required a showing that the respondent has acted in bad faith before liability can be found. There is no bad faith requirement, however, when, as here, a violation of [the J&E Rule] is based upon the violation of a Commission rule." 85 SEC Docket at 1302-03.

[33] The order included a footnote describing Jautz as "(holding that if only violation alleged by NASD is failure to observe just and equitable principles of trade, there must be a finding of bad faith)." 89 SEC Docket at 1282 n.3. As previously noted, the Jautz decision itself was based on the contractual context of that case. See supra note 28.

that "Fox's alleged conduct was in bad faith and unethical,"[34] although our decision did not address those findings. Given the applicant's late filing, our order did not address the merits of the hearing panel's findings or analysis under the rule.[35]

Thus, neither the Avello decision nor the Fox order was based on the standard to be applied to J&E Rule violations in the absence of another rule violation. In Avello, the applicant had violated another rule, and in Fox, we dismissed the appeal without reaching the merits. Accordingly, dicta in these decisions may not reasonably be read as signaling a rejection of the Commission's longstanding liability standard under the J&E Rule.

Heath also cites various cases in which we credited equitable excuses to reverse SRO findings of violations of the J&E Rule. These cases are also distinguishable from the direct breach of a duty to a client presented here.[36] None of these opinions held

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[34] Fox, 89 SEC Docket at 1282.

[35] The Fox order also notes that in our earlier order remanding the proceeding, "we asked the NYSE to address whether Fox's alleged conduct was in bad faith or unethical." 89 SEC Docket at 1282 (emphasis added).

[36] See George R. Beall, 50 S.E.C. 230, 231 (1990) (failure to repay debt to prior employer when the debt had been forgiven decided as breach of contract); George, 47 S.E.C. at 369-70 (failure to reimburse customer under indemnity agreement in the absence of bad faith decided as breach of contract); Kirk A. Knapp, 51 S.E.C. 115, 120 n.20 (1992) (inaccurate NASDAQ filing for which respondent was not responsible); Charles Zandford, 50

(Continued on following page)

that good faith is a per se defense to a violation of the J&E Rule, and the analysis in these cases often emphasized the unusual circumstances at issue.[37] Moreover, none of these cases credited a good faith defense for an applicant that, like Heath, violated a non-contractual fiduciary duty owed directly to a client or customer.

B. Fair Notice Challenge to J&E Rule

Heath also contends that he lacked notice that the NYSE could discipline under the J&E Rule for unethical conduct that was not motivated by bad faith. The Supreme Court has stated that notice arguments "may be overcome in any specific case where reasonable persons would know that their conduct is at risk."[38] Notice requirements should not be "mechanically applied" but rather are to be evaluated

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S.E.C. 782, 783-84 (1991) (deposit of personal funds to cover a margin call based on the advice of officials responsible for margin compliance); James Anthony Morrill, 51 S.E.C. 1162, 1165 (1994) (failure to pay an arbitration award when respondent did not receive notice of the award hearing and relied on advice of SRO official).

[37] See Morrill, 51 S.E.C. at 1164-65 (noting the "unusual situation" in which respondent was pro se and "evidently in good faith, repeatedly brought to the NASD's attention the NASD's apparent failure to give him notice of the rescheduled arbitration hearing"); Zandford, 50 S.E.C. at 783 (noting "the exceptional circumstances of this case -- particularly Zandford's good faith reliance on the advice and counsel of . . . management, including the official in charge of margin requirements").

[38] Maynard v. Cartwright, 486 U.S. 356, 361 (1988).

based on the context of the regulation at issue.[39] Accordingly, Heath's notice claim should be evaluated with respect to his "actual conduct" and not "hypothetical situations at the periphery of the [rule's] scope or . . . the conduct of other parties who might not be forewarned by . . . broad language" in the rule.[40]

The Commission and the federal courts have consistently sustained SRO disciplinary decisions based on a finding of unethical conduct under the J&E Rule, deeming the rule fairly applied to conduct that "is not ethical and accepted conduct in the securities industry."[41] In reviewing notice challenges to the J&E Rule,

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[39] Village of Hoffman Estates v. Flipside, 455 U.S. 489, 498 (1982) ("The degree of vagueness that the Constitution tolerates -- as well as the relative importance of fair notice and fair enforcement -- depends in part on the nature of the enactment."). Although the Court noted that "a scienter requirement may mitigate a law's vagueness, especially with respect to the adequacy of notice," the Court did not hold that scienter is always required to withstand vagueness review. Id. at 499.

[40] diLeo v. Greenfield, 541 F.2d 949, 953 (2d Cir. 1976).

[41] Rooms v. SEC, 444 F.3d 1208, 1214 (10th Cir. 2006); see also Alderman v. SEC, 104 F.3d 285, 288-89 (9th Cir. 1997) (finding, when respondent violated duty to act in accordance with "NASD ethical standards," the application of the J&E Rule based on the violation of such duties "cannot have come as a surprise"); Sorrell v. SEC, 679 F.2d 1323, 1326 (9th Cir. 1982) (rejecting due process challenge to J&E Rule). Accord Shultz, 614 F.2d at 371 (holding that a disciplinary rule requiring that market makers "contribute to the maintenance of a fair and orderly market" is "appropriately specific to withstand constitutional scrutiny").

courts have expressly recognized that "an experienced registered representative . . . may be fairly charged with knowledge of the ethical standards of his profession."[42] Courts have consistently found that the rule "is sufficiently specific and provides an adequate standard of compliance,"[43] even as applied to conduct that does not involve securities or employment-related activities.[44]

As an experienced investment banker, Heath can be fairly charged with notice that his breach of his duty to maintain the confidentiality of his client's information violated the just and equitable principles of trade. Any reasonably prudent securities professional would recognize that the disclosure of confidential client information violates the ethical norms of the industry. Moreover, Heath had actual notice of his duty to maintain the confidentiality of his client's information, further undermining his notice challenge. Heath acknowledged that he had read the JPMorgan Code of Conduct, which explicitly codified his obligation to maintain the strict confidentiality of client information. Heath also testified as to his

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[42] Crimmins v. Am. Stock Exch., 368 F. Supp. 270, 277 (S.D.N.Y. 1973), aff'd 503 F.2d 560 (2d Cir. 1974).

[43] Werner v. SEC, 44 S.E.C. 622, 625 & n.11, aff'd without opinion (D.C. Cir. 1972); see also Rooms, 444 F.3d at 1214; Alderman 104 F.3d at 288.

[44] Vail v. SEC, 101 F.3d 37, 39 (5th Cir. 1996) (per curiam) ("Vail had fair notice" that his non-work conduct "would subject him to sanctions by the NASD.").

knowledge of the importance of maintaining client confidentiality, stating that "one of the factors that creates a successful M&A banker is . . . having the judgment of how to use [confidential information] and how to use it in a trustworthy and honest way."

Heath nonetheless argues that he did not have notice that the terms "unethical" and "bad faith," as those terms are used in applying the rule, are meant to have separate meanings. We find this argument unpersuasive. Heath's interpretation deprives the disjunctive language in the standard of any meaning and is contrary to well-established Commission precedent explicitly finding J&E Rule liability without a finding of bad faith. As previously discussed, Heath does identify certain instances of dicta suggesting a bad faith standard for J&E Rule violations. However, given our longstanding interpretation of the rule as covering bad faith or unethical conduct, those isolated instances of dicta could not reasonably be interpreted as signaling a reversal of existing precedent directly addressing the standard for liability under the J&E Rule.[45]

Heath cites a series of cases involving disciplinary proceedings against accountants under our former Rule of Practice 2(e).[46] These cases held that disciplinary action under former Rule 2(e) must be

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[45] See supra nn. 29-37 and accompanying text.

[46] 17 C.F.R. § 201.2(e)(1) (1993) (amended and recodified as 17 C.F.R. § 201.102(e)).

premised on notice of the standard governing the rule, including a specific mental state standard.[47] Heath cites Checkosky v. SEC,[48] which held that liability under Rule 2(e) must be based on notice of the mental state "necessary and sufficient" to violate the rule. However, the court's analysis in Checkosky was grounded in our implementation of Rule 2(e) under our "general rulemaking authority"[49] without a specific statutory mandate.[50] Under these circumstances, the court cautioned that a broad interpretation of the rule could be deemed "a de facto substantive regulation of the profession" and would "raise questions as to the legitimacy of the rule."[51]

Unlike former Rule 2(e), the Exchange's authority to impose "substantive regulations" on the conduct of securities professionals is grounded in an explicit and longstanding statutory mandate. The Securities Exchange Act of 1934 expressly grants SROs the "statutory responsibility to prevent unethical practices

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[47] See Checkosky v. SEC ("Checkosky I"), 23 F.3d 452 (D.C. Cir. 1994); Checkosky v. SEC ("Checkoksy II"), 139 F.3d 221 (D.C. Cir. 1998); Marrie v. SEC, 374 F.3d 1196 (D.C. Cir. 2004).

[48] Checkosky I, 23 F.3d at 458.

[49] Id. at 456.

[50] The Commission's authority under Rule 102(e) was subsequently codified in the Sarbanes-Oxley Act of 2002, 15 U.S.C. §78d-3. See Marrie, 374 F.3d at 1203.

[51] Checkosky I, 23 F.3d at 459; see also Marrie, 374 F.3d at 1205 ("The Commission's authority to discipline professionals has long been distinguished from the execution of its substantive enforcement functions.").

among its membership."[52] Section 6(b)(5) of the Exchange Act directs national securities exchanges to promulgate and enforce disciplinary rules, among other things, "to promote just and equitable principles of trade . . . and, in general, to protect investors and the public interest."[53] In associating with the Exchange, securities professionals "voluntarily subject [themselves] to the NYSE rules,"[54] and recognize the Exchange's authority "to discipline their members for unethical behavior as well as violations of law."[55] In contrast to the former distinction between our "authority to discipline professionals" under Rule 2(e) and "the execution of [our] substantive enforcement functions,"[56] the J&E Rule reflects an integral part of the Exchange's express regulatory mandate under the Exchange Act.

Moreover, the court recognized in Marrie that "professional disciplinary rules have withstood vagueness

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[52] Valley Forge Sec. Co., 41 S.E.C. 486, 490 (1963).

[53] 15 U.S.C. § 78f(b); cf. 15 U.S.C. § 78o-3(b)(6) (comparable provision for national securities associations).

[54] Gold v. SEC, 48 F.3d 987, 993 (7th Cir. 1995); see also Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Georgiadis, 903 F.2d 109, 113 (2d Cir. 1990) (indicating that the obligations of securities professionals under the disciplinary rules are "contractual in nature").

[55] Paul K. Grassi, Jr., Exchange Act. Rel. No. 52858 (Nov. 30, 2005), 86 SEC Docket 2494, 2497.

[56] Marrie, 374 F.3d at 1205.

challenges,"[57] and the Rule 2(e) cases cited by Heath do not suggest that the state of mind requirements were meant to be broadly applied to all such disciplinary rules.[58] We note that courts have rejected notice challenges to disciplinary rules as applied to a wide range of professions without imposing state of mind requirements.[59] Such challenges have failed even when the regulation "is admittedly flexible, and officials implementing [the] standard will undoubtedly

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[57] See id. (observing that "the Commission could reasonably conclude that any licensed accountant is on notice of professional standards generally. . . . For this reason, professional disciplinary [r]ules have withstood vagueness challenges.").

[58] Although Heath cites a case addressing requisite state of mind findings in disciplinary action taken by the Patent and Trademark Office ("PTO"), the court's analysis in that case focused on whether the PTO's complaint sufficiently charged a violation of the relevant disciplinary rule. Halvonik v. Dudas, 398 F. Supp. 2d 115, 125 (D.D.C. 2005), aff'd, 192 Fed. Appx. 964 (D.C. Cir. 2006) (mem. per curiam).

[59] See, e.g., Arnett v. Kennedy, 416 U.S. 134, 164 (1973) (regulation authorizing discipline of civil servant "for such cause as will promote the efficiency of the service"); Perez v. Hoblock, 368 F.3d 166, 169 (2d Cir. 2004) (racing community rule prohibiting "any action detrimental to the best interests of racing"); LeRoy v. Illinois Racing Board, 39 F.3d 711, 715 (7th Cir. 1994) (racing community rule forbidding "'improper language' or 'improper conduct' by licensees toward regulators"); U.S. v. Hearst, 638 F.2d 1190, 1197 (9th Cir. 1980) (disciplinary rule prohibiting "conduct unbecoming a member of the bar"); diLeo, 541 F.2d at 953 (teacher disciplinary rule authorizing disciplinary action for "other due and sufficient cause . . . "); Allen v. City of Greensboro, 452 F.2d 489, 491 (4th Cir. 1971) (disciplinary regulation for police officers prohibiting conduct "unbecoming an officer and a gentleman").

exercise some discretion in interpreting and applying the regulation."[60] In assessing such notice claims, courts have evaluated the conduct at issue against the professional "norms" of the vocation or profession "as embodied in codes of professional conduct,"[61] but do not require specific state of mind findings.[62] As discussed above, Heath's disclosure of his client's confidential information violated such norms.

We conclude that Heath failed to demonstrate that he lacked notice that his conduct violated the just and equitable principles of trade covered under the J&E Rule. Heath's disclosure of confidential client information clearly violated the ethical norms of securities professionals protected under the rule. Heath's position is further undercut by the express restrictions on the use of client information in the Code of Conduct.

C. Circumstances Surrounding Heath's Disclosure

Heath points to circumstances which, he claims, excuse his actions based on the context of his disclosure. He asserts that, "[v]iewed objectively, what Mr. Heath did and the reasons for his conduct do not support any finding of wrongdoing approaching bad

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[60] Perez, 368 F.3d at 175.

[61] In re Snyder, 472 U.S. 634, 645 (1985) (interpreting attorney disciplinary rule prohibiting "conduct unbecoming a member of the bar").

[62] Perez, 368 F.3d at 175-76.

faith." Among other things, Heath notes that his disclosure was not premeditated, resulted in no personal enrichment and had no effect on the deal or the markets. We are not persuaded, however, that any of the circumstances cited by Heath absolve his conduct; although, as discussed below, they were considered by the Exchange in determining sanctions and by us in assessing those sanctions.

Heath further claims in particular that he was "authorized -- or, at least, was actively attempting -- to protect Hibernia's interest by making the disclosure to freeze out Mr. Corrigan." However, Heath's decision to divulge unquestionably confidential information was not justified on this basis. The record does not indicate that Heath could have reasonably believed that Corrigan was in a position to threaten the transaction, or that detailed disclosure was otherwise necessary to protect Hibernia's interests. The transaction had not been publicly announced and Corrigan had not indicated that he had access to any information sufficient to jeopardize the acquisition. When Corrigan referenced "rumors in the marketplace" about "a bank deal somewhere in the south," the reasonable course of action for protecting Hibernia's interest was to decline to discuss the transaction. Instead, Heath chose to divulge highly sensitive information about the critical terms of the transaction.

In addition, Heath cites the testimony and support of a former officer and director of Hibernia who stated that he did not consider Heath's disclosure to be a breach of Hibernia's confidence under the

circumstances. However, this former officer testified in his individual capacity, and the record suggests that he was not aware of the disclosure until after it had been made. Heath's duty of confidentiality was owed to Hibernia as his investment banking client -- not to any individual Hibernia officer or director. At the time of Heath's conversation with Corrigan, Heath did not have general authorization to disclose information about the merger except on a need-to-know basis. In the absence of express prior authorization from his client and in accordance with the Code of Conduct, Heath remained bound by his obligation to safeguard information about the acquisition solely for Hibernia's interest.

Heath further argues that he viewed Corrigan as a future colleague and believed that Corrigan had an independent duty to keep the information confidential. In this regard, he cites Corrigan's express assurance of confidentiality and also argues that Corrigan had a separate duty to keep the information confidential because BofA had represented Capital One in other transactions. However, even if Heath did not believe that Corrigan was permitted to act on the information, that belief did not absolve Heath's own disclosure. Heath owed a duty of confidentiality directly to Hibernia, and Corrigan had no legitimate interest in information about the acquisition before the public announcement of the deal. In choosing to disclose the information, Heath favored his interest in establishing a collegial relationship with Corrigan over his client's interest in the confidentiality of highly

sensitive and material pricing information. Nor are we persuaded that the lack of demonstrable client harm in this instance excused his disclosure. The ethical prohibition on the disclosure of confidential client information is not contingent upon future harm.[63]

V.

Heath also asserts that the hearing officer erred in granting the Division's motion for summary judgment.[64] Heath argues that the hearing officer did not resolve questions of fact and draw all reasonable inferences in his favor as required by the first prong of the summary judgment standard. Among other things, Heath argues that the hearing officer did not appropriately consider: Corrigan's responsibility to keep the information confidential; Heath's desire to prevent Corrigan from soliciting business in the transaction; testimony from the former Hibernia

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[63] See Reuben, 46 S.E.C. at 722 n.7 ("The absence of actual harm is of little, if any, mitigative moment. This is not a civil action to collect money damages. It is an ethical proceeding. Hence our concern is with the ethical implications of the applicant's conduct. Those implications can be serious even where, as here, no legally cognizable wrong was inflicted.").

[64] In the absence of a legal standard governing summary judgment in the NYSE rules, the hearing officer looked to the Federal Rules of Civil Procedure two prong test for summary judgment when "there is no genuine issue as to any material fact and . . . the moving party is entitled to judgment as a matter of law." Fed. R. Civ. P. 56(c).

executive indicating that he did not consider the disclosure to be a breach of confidentiality; and a purported lower risk of harm to the client from the disclosure "given the advanced stage of the" deal. Heath also contends that the second prong of the summary judgment standard was not satisfied, arguing that the J&E Rule requires a "fact sensitive . . . nuanced determination rarely susceptible to a ruling as a matter of law."

In evaluating Heath's arguments on appeal, we have conducted a de novo review of the record. The record includes Heath's on-the-record testimony taken by the Division during its investigation, and Heath's testimony before the NYSE Hearing Panel during the penalty phase of the NYSE hearing. While Heath has disputed whether his disclosure breached his duty to Hibernia, he does not contest the material facts underlying the NYSE's finding of a violation of the rule, i.e., his disclosure of material non-public information regarding the pending merger of his client and the circumstances surrounding his conversation with Corrigan. As noted above, the Exchange's liability finding was based on Heath's violation of established standards of conduct in the industry. Based on our de novo review, we find that the justifications advanced by Heath do not ultimately excuse his breach of one of the most critical responsibilities of a financial advisor. Under the circumstances, we

find no prejudice to Heath resulting from the hearing officer's ruling.[65]

VI.

Section 19(e)(2) of the Exchange Act directs us to sustain the NYSE's sanctions unless we find, having due regard for the public interest and the protection of investors, that the sanctions are excessive or oppressive or impose an unnecessary or inappropriate burden on competition.[66] Heath does not claim, and the record does not show, that the NYSE's action was excessive or oppressive or imposed an undue burden on competition.

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[65] See McCarthy v. SEC, 406 F.3d 179, 187 (2d Cir. 2005) (finding that the "due process afforded [the applicant] before the Commission cured any alleged defect" in the proceedings before the NYSE); see also Sorrell v. SEC, 679 F.2d 1323, 1326 (9th Cir. 1982).

The disposition of this case was simplified by the clear breach of confidentiality, and the undisputed facts underlying the violation. The unique factual circumstances of this case notwithstanding, we note that the hearing record for SRO disciplinary action is often best-served by restraint in the granting of summary judgment on the issue of liability. See Frank P. Quattrone, Exchange Act Rel. No. 53547 (Mar. 24, 2006), 87 SEC Docket 2155, 2166 (setting aside NASD action when "NASD improperly granted summary disposition on" the issue of liability). Such restraint is particularly appropriate when the central issue is whether the respondent's conduct violated industry norms.

[66] 15 U.S.C. § 78s(e)(2).

The violation here is "neither technical nor esoteric."[67] Heath disclosed information he knew to be "obviously confidential" regarding the parties, structure and pricing of a pending merger, even if Heath did not perceive his disclosure as violating his duty of confidentiality. The ability to credibly assure a client that such information will be used solely to advance the client's own interests is central to any securities professional's ability to provide informed advice to clients. Disclosure of such information jeopardizes the foundation of trust and confidence crucial to any professional advising relationship. Whether or not the disclosure ultimately harmed his client, it violated the ethical standards to which all members of the industry must adhere and which the Exchange is charged with protecting.

In determining the sanctions, the Exchange considered the mitigating circumstances in this case, including among other things: the lack of premeditation, bad faith, direct client harm or personal enrichment, Heath's elevation of the issue at BofA and cooperation with the Exchange's investigation, and the promise of confidentiality he received from a future colleague. The Exchange also credited Heath's reputation for integrity and trustworthiness, sincere remorse, and the unlikelihood of repetition of the violative conduct. The Exchange ultimately declined to impose an industry bar but felt that a substantial

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[67] Protective Group Sec. Corp., 51 S.E.C. 1233, 1242 (1994).

fine was warranted by the serious nature of Heath's conduct. Under all the circumstances, we agree. We also find that the sanctions imposed by the Exchange were consistent with the public interest. Accordingly, we sustain the NYSE action.

An appropriate order will issue.[68]

By the Commission (Chairman COX and Commissioners CASEY, AGUILAR, and PAREDES); Commissioner WALTER not participating.

Elizabeth M. Murphy
Secretary

/s/ Jill M. Peterson
By: Jill M. Peterson
Assistant Secretary

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[68] We have considered all of the parties' contentions. We have rejected or sustained them to the extent that they are inconsistent or in accord with the views expressed in this opinion.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 59223 / January 9, 2009

Admin. Proc. File No. 3-12890

In the Matter of the Application of

THOMAS W. HEATH, III
c/o Gary P. Naftalis
Kramer Levin Naftalis & Frankel LLP
1177 Avenue of the Americas
New York, New York 10036

For Review of Disciplinary Action Taken by

NYSE REGULATION, INC.

ORDER SUSTAINING DISCIPLINARY ACTION TAKEN BY NATIONAL SECURITIES EXCHANGE

On the basis of the Commission's opinion issued this day, it is

ORDERED that the disciplinary action taken by NYSE Regulation, Inc. against Thomas W. Heath, III, be, and it hereby is, sustained.

By the Commission.

Elizabeth M. Murphy
Secretary

/s/ Jill M. Peterson
By: Jill M. Peterson
Assistant Secretary

[LOGO] NYSE Regulation

In the Matter of	)	Request for Review
	)	of NYSE Hearing
Thomas Woodley Heath, III	)	Board Decision 07-25

Respondent Thomas Woodley Heath, III, requested review of a Hearing Officer's summary judgment order finding him guilty of engaging in conduct inconsistent with just and equitable principles of trade in violation of NYSE Rule 476(a)(6). He also requested review of the penalty imposed by the Hearing Panel. In accordance with NYSE Rule 476(f), after a consideration of the record in this matter, written submissions filed by the parties and oral argument, the Board affirms the decisions of the Hearing Officer and the Hearing Panel.

The Hearing Officer correctly determined that "conduct inconsistent with just and equitable principles of trade," as codified by NYSE Rule 476(a)(6), may be established by a finding of either bad faith or unethical conduct. In light of the foregoing, the Board did not reach the question of whether the record did in fact establish that the Respondent's conduct amounted to bad faith. Moreover, in granting summary judgment in favor of the Division of Enforcement, the Hearing Officer properly viewed all facts and made all reasonable inferences in the light

most favorable to the Respondent. The penalty imposed was appropriate.

October 17, 2007

By the Board of Directors
NYSE Regulation, Inc.

NEW YORK STOCK EXCHANGE LLC

NYSE HEARING BOARD **March 15, 2007**
DECISION 07-25
THOMAS WOODLEY HEATH, III
FORMER REGISTERED REPRESENTATIVE

* * *

Violated NYSE Rule 476(a)(6) by disclosing material, non-public information regarding pending acquisition – Censure and $100,000 fine.

Appearances:

For the Division of Enforcement
Linda S. Riefberg, Esq.
Martin S. Mazur, Esq.
Kathleen S. Lynch, Esq.
George Tidona, Esq.
David Camuzo, Esq.

For Respondent
Gary P. Naftalis, Esq.
Alan R. Friedman, Esq.
Michael Oberman, Esq.
Joel M. Taylor, Esq.
Michael Eisenkraft, Esq.

* * *

A Charge Memorandum was issued by NYSE Regulation, Inc.'s Division of Enforcement ("Enforcement") charging Thomas Woodley Heath, III ("Respondent"), a former registered representative with JP Morgan Securities Inc. ("JP Morgan" or the "Firm"), a member organization, with having engaged in conduct inconsistent with just and equitable principles of trade in violation of NYSE Rule 476(a)(6) by disclosing material, non-public information regarding a pending acquisition.

Respondent filed an Answer, in which he admitted some of the allegations in the Charge Memorandum, denied others, and denied the charges.

Enforcement and Respondent each filed a motion for summary judgment. After briefing by the parties, the Hearing Officer granted Enforcement's motion and denied Respondent's motion (the "Summary Judgment Order"). The Summary Judgment Order is attached to this Decision as Appendix A.

A Hearing Panel on behalf of the New York Stock Exchange LLC ("NYSE") was convened to hear evidence and argument concerning the penalty to be imposed. Subsequent to the hearing, Enforcement requested leave to file a post-hearing brief on the issue of a retroactive sanction, and such leave was granted. Thereafter, Enforcement and Respondent each filed a post-hearing brief addressing this issue.

As set forth in the Summary Judgment Order, the Hearing Officer accepted the following facts in resolving the parties' respective motions for summary judgment:

Background and Jurisdiction

1. Respondent was employed in the Financial Institutions Group at the Firm from 1992 to 2005. At the Firm, Respondent had cultivated a relationship with Bank A, which allowed him to facilitate the hiring of the Firm by Bank A as its financial advisor in a merger with Bank B in February 2005.

2. In January 2005, Respondent received an unsolicited call from the Global Head of Investment Bank C's Financial Institutions Group ("AU") to discuss the possibility of Respondent's joining Investment Bank C. After a subsequent meeting, Respondent told AU that Respondent believed that it would not work out.

3. After a second call from AU, Respondent met with AU in person in early February 2005. At that meeting, AU made Respondent an offer to join Investment Bank C as head of its Global Financial Institutions Group in exchange for compensation amounting to at least $3 million per year for the first two years. On or around February 13, 2005, after meeting with several people at Investment Bank C, Respondent accepted AU's offer.

4. At AU's behest, during the afternoon of March 1, 2005, Respondent had a telephone conversation with the then head of Investment Bank C's depository institutions group ("EC"). According to Respondent, the purpose of the conversation was to demonstrate to EC that Respondent "was a 'decent guy' and a 'good partner'" who was not going to stomp all over him."

5. During this conversation, Respondent disclosed to EC material, nonpublic information concerning the acquisition that Respondent was in the process of finalizing at the Firm, including: (1) the identity of the acquirer (Bank B) and the target (Bank A);

(2) the fact that Respondent's firm was representing Bank A in the deal; (3) Bank A's belief that Bank B's price-to-earnings ratio was at such a low that it gave Bank A a "degree of comfort with the stock;" and (4) the fact that the deal was 45% cash.

DECISION

For the reasons set forth in the Summary Judgment Order, which is incorporated hereto and made a part hereof, the Chief Hearing Officer found Respondent guilty of the one Charge set forth in the Charge Memorandum, namely, that Respondent engaged in conduct inconsistent with just and equitable principles of trade in violation of NYSE Rule 476(a)(6) by disclosing material, non-public information regarding a pending acquisition. See Appendix A.

PENALTY

The Hearing Panel heard evidence at a hearing held to determine the penalty that should be imposed in this matter. Enforcement presented the testimony of a current managing director at the Firm who was a colleague of Respondent's. Respondent presented testimony from several witnesses: a former member of Bank A's board of directors; an attorney who formerly worked as general counsel and as an investment banking executive and close colleague of Respondent's at the Firm ("EJK"); and Respondent himself.

Respondent testified that he "very specifically pledged [EC] to absolute confidentiality" prior to disclosing the confidential information to him and that Respondent did so because EC was "asking me [Respondent] to trust him [EC]." (Penalty Hearing Transcript ("Tr.") at 221.) Respondent also testified that the disclosure came in the last two minutes of a 41-minute telephone conversation, while he was packing his bags in a hotel room in New Orleans, preparing to return to New York. Id. at 217-18. Respondent further testified that, several days after his disclosure to EC, Respondent learned from EC that the latter had disclosed to a third party at Bank C ("TC") the material, non-public information in question. Respondent and EC placed a call together to TC and learned that the latter had contacted Bank B in an unsuccessful attempt to obtain on behalf of Investment Bank C a part of Bank B's investment banking business in connection with the pending merger. (See id. at 229-31.)

Enforcement argued that a penalty of a censure, a six-month bar and a $200,000 fine was reasonable and appropriate in this matter. Enforcement stated that this was a "very unique case," (id. at 375) and that no prior case before the Hearing Board had ever involved a disclosure of confidential information by an investment banker. Therefore, Enforcement contended, there is no relevant precedent to aid the Panel in its determination of the appropriate penalty in this case. (See id. at 375-76 (Enforcement stating that it "could not find any other cases in the

precedents anywhere near close to this [case]."){ Instead, as grounds for its proposed penalty, Enforcement set forth the following arguments: (1) Respondent's breach of confidentiality was not a mistake, but rather, the result of a deliberate choice; (2) after his breach, Respondent did nothing to alert the Firm or his client; (3) at the time of the breach, there was the potential for harm—such as an unraveling of the deal or volatility in the market—even though no such harm actually occurred; (4) Respondent, given his many years of experience as an investment banker should have known better; (5) a less severe penalty, such as a mere censure, would send the wrong message to the securities industry, insofar as it would create no "disincentive for committing this kind of a violation;" and (6) given the large amounts Respondent was earning at the time, according to Enforcement, "$200,000 is not a lot of money." {Id. at 377-81.}

Respondent argued that several precedents were relevant. He cited several cases in which respondents entered into a Stipulation of Facts and Consent to Penalty, each of which involved a disclosure of confidential information and an expectation of improper trading or actual harm to the market. See Daniel Thomas Lemaitre, Decision 05-179 (Feb. 8, 2006) (censure, two-month bar, and $25,000 fine where senior research analyst disseminated to clients confidential information regarding clinical results of medical technology company that he covered); Peter John Caruso, Decision 04-83 (NYSE Hearing Board

May 19, 2004) (censure, four-month bar, and $25,000 fine where research analyst disclosed to clients that he was about to downgrade his rating on stock prior to public dissemination of that downgrade); William Edward Evans, II, Decision 02-166 (NYSE Hearing Board Aug. 20, 2002) (censure and two-month bar where registered representative, without firm approval, posted speculative statements on Internet concerning security that he and his customers owned); Stuart Leslie Weisbrot, Decision 02-84 (NYSE Hearing Board Apr. 11, 2002) (same); Jens Dalsgaard, Decision 99-121 (NYSE Hearing Board Sept. 14, 1999) (censure and $15,000 fine for circulating rumors on Internet that were expected to affect investor interest in subject security). Unlike in those cases, there was no actual harm in the case before us and, according to Respondent, no risk of harm because the transaction was so close to completion at the time of the disclosure; therefore, Respondent contended that the penalty in this case should be much lower than the penalties imposed in the cases he cited.

In addition, Respondent pointed out that he obtained no personal enrichment from his conduct; on the contrary, Respondent argued, he has already incurred a very high personal cost, including the loss of a minimum annual income of $3 million for 2005 and 2006 and his inability to find work in the 22 months following the incident and his termination. Respondent specifically testified that he had been approached by nine different firms and had gone on

numerous interviews but had not received a single offer of employment. [Tr. at 252-55.] One firm explicitly communicated to him that the "uncertainty" surrounding this disciplinary case caused the firm to decline to make him an offer of employment. [Id. at 255.] Respondent's former colleague FJK testified at the hearing that the outcome of this case will likely have an impact on Respondent's ability to obtain employment in the investment banking industry again. [Id. at 340.] Respondent also argued that there was no evidence of bad faith or deceit on his part; rather, his disclosure was "a spontaneous thing that happened in the 38th or 39th minute of a 41-minute conversation . . . where he was kind of blindsided . . . [because] he didn't expect this to come up, had never anticipated it coming up, [and] never planned on having this conversation." [Id. at 360.] Finally, Respondent argued that, in the ensuing investigation and disciplinary proceedings, he has been consistently forthcoming and candid about his conduct. In light of these considerations, Respondent argued that a letter of admonition would be sufficient punishment.

The purpose of a disciplinary sanction is to "protect investors, not to penalize brokers." McCarthy v. SEC, 406 F.3d 179, 188 (2d Cir. 2005). Relevant factors to be considered in determining a penalty that is appropriately remedial include "the seriousness of the offense, the corresponding harm to the trading public, the potential gain to the broker for disobeying the rules, the potential for repetition in light of the

current regulatory and enforcement regime, and the deterrent value to the offending broker and others. . . ." Id. at 190. Other factors include the degree of scienter or bad faith, any prior disciplinary record, the respondent's financial resources, and the degree to which a respondent has cooperated with regulators. See Factors Considered by the New York Stock Exchange Division of Enforcement in Determining Sanctions, Info. Memo. 05-77 (Oct. 7, 2005) ("Info. Memo.") at 2-4.

The Hearing Panel regards the nature of the violation in this case to be very serious, warranting a serious penalty. The unauthorized disclosure of sensitive information regarding a very large pending corporate transaction has the danger of improperly disrupting the market. Indeed, the integrity of our capital markets depends on the ability of market participants to trust that material, non-public information will be kept confidential until it is ready for widespread, public dissemination. Even if no harm or undue enrichment occurs as a result of a given disclosure—as was true in this case—the risk of harm is real and itself carries a cost for all because of the potential instability it creates in the marketplace.

Nevertheless, in fashioning an appropriate penalty, the Hearing Panel considers not only the seriousness of the violation, but also the specific facts of the particular case, including any aggravating or mitigating factors. As the Second Circuit has held, "each case must be considered on its own facts," and "[s]ome explanation addressing the nature of the

violation and the mitigating factors presented in the record of each case is required." McCarthy, 406 F.3d at 190. While we have acknowledged above the seriousness of Respondent's violation, we find that several mitigating factors weigh in his favor.

First, we find that the risk of harm from the disclosure in this particular case—for example, the risk of loss for the shareholders of Bank A or Bank B, or for the corporations themselves, that could have resulted had the deal unraveled—was small given the advanced stage of the negotiations and of the due diligence process at the time of the disclosure. The deal was in fact consummated only three days after the disclosure. Moreover, the undisputed testimony of both Respondent and the former director of Bank A established that, by the time TC had contacted Bank B to solicit its business in connection with the pending merger, the transaction was virtually complete. For example, the final price had been agreed to, and the investment bankers had been formally retained.

We also find that Respondent lacked any bad faith. Respondent only shared the confidential information with EC after making the latter promise that he would not share it with anyone else, and Respondent had every reason to believe that EC would keep his promise, since the consequences for breaching that promise would be dire, as they indeed turned out to be. Among other things, EC was himself terminated by Investment Bank C, as was TC. Further, we accept that Respondent did not make the disclosure with

premeditation, but rather, did so as a result of a momentary lapse in judgment, in the "39th minute of a 41-minute conversation." His undisputed testimony further established that, as soon as Respondent discovered that EC had disclosed the confidential information to TC—who, in turn, referred to that information in his business solicitation of Bank B—Respondent insisted on elevating the issue at Investment Bank C, even though his soon-to-be boss there told him that it was nothing to worry about. We believe that these circumstances demonstrate the absence of bad faith and, thus, weigh in favor of a less severe penalty.

We note also that Respondent demonstrated honesty in consistently admitting his actions throughout the disciplinary process, starting from the time of his on-the-record testimony to Enforcement, which Enforcement essentially conceded in its opening argument. [See Tr. at 11 ("Another factor [that works in Respondent's favor] is that he testified during a deposition before Enforcement and he admitted disclosing this material nonpublic information to [EC].")]

Furthermore, while the Panel believes that Respondent used poor judgment and was motivated by a desire to gain the trust of a future colleague, we are satisfied that Respondent's breach of confidentiality was not motivated by any improper goal of personal enrichment, nor did he obtain any. As a direct result of this one indiscretion, Respondent lost his job, had his $3-million-a-year offer from Bank B

rescinded, and has now been out of work for approximately two years, despite repeated, assiduous attempts to secure employment.

The Panel finds that Respondent is not likely to repeat his violative conduct. Having heard Respondent's testimony and having had the opportunity to observe his demeanor and ask him questions, we are convinced that he understands the gravity of his actions, has sincere remorse for what he has done, and will not repeat the behavior for which he has already suffered. Furthermore, the significant loss that Respondent has already incurred stems from a single violative act, which was itself the result of a momentary lapse in judgment in an otherwise exemplary twelve-and-a-half-year career. Indeed, Respondent's reputation for integrity and trustworthiness was emphasized by the credible testimony of his former colleague, EJK, in addition to the 29 letters of support that Respondent submitted from former colleagues, former clients, family, and friends.

Finally, the respondent's current financial resources may also be taken into account as a factor affecting penalty. See Info. Memo. 05-77. In determining the appropriate sanction in this case, we are mindful that, even though Respondent was an investment banker who earned considerable sums in the past, he has lost a large amount of income over the last two years, as noted above.

The Panel agrees with Enforcement that this case is unique, but we do not agree that it is wholly without

precedent. The cases cited by Respondent also entailed unauthorized disclosures of confidential information, albeit involving non-investment bankers and under circumstances that were more likely to involve some effect on the market. In those cases, fines in the low five-figures were imposed, sometimes in conjunction with a two- to four-month bar. While the Panel acknowledges that in order to serve as an effective deterrent to Respondent and to others in the industry, a fine imposed on an investment banker should likely be greater than that imposed on a research analyst, we also take into account that Respondent did not profit—and did not intend to so profit—from his actions, and that he has already lost a significant amount of income. Accordingly, we reject the $200,000 fine proposed by Enforcement as unduly punitive.

In light of all the facts and circumstances of this case, the Hearing Panel concludes that a penalty of a censure and $100,000 fine is reasonable and appropriate and will be sufficient to protect the investing public by deterring Respondent and others from committing similar violations in the future. The Panel does not find that imposing a bar on Respondent at this point will serve to protect the investing public. At the time of the hearing, Respondent had already been effectively out of the industry for 22 months. The Hearing Panel accepts that the outcome of this proceeding will have a direct and significant impact upon Respondent's future ability to earn a living. Under the circumstances, and

taking into consideration all of the mitigating factors in this case, the Panel finds that forcing him to spend additional time outside of the industry would be unduly punitive. As the Second Circuit has observed, when considering a bar or suspension, our "foremost consideration must . . . be whether [the] sanction protects the public from further harm." McCarthy, 406 F.3d at 188. In that case, the court vacated a two-year suspension that had been imposed by the SEC, noting that:

> The record [in this case] contains mitigating facts and circumstances from which a compelling argument can be made that suspending McCarthy now will not serve remedial interests and will work an excessive and punitive result—namely, the destruction of the brokerage practice McCarthy has built during several years of rule-abiding trading.

McCarthy, 406 F. 3d at 190. After a careful review of all of the facts and circumstances, we have come to a similar conclusion in this case, namely, that suspending Respondent at this point in time would not enhance investor protection or serve any other remedial interest, but rather, would simply lead to an excessive and punitive result.

In light of the above, the Hearing Panel has determined to impose the penalty of a censure and a $100,000 fine.

For the Hearing Panel

/s/ Peggy Kuo
Peggy Kuo –
Chief Hearing Officer
Panelists:
Stefan Papasoff
Stewart J. Teichman

Appendix A

NEW YORK STOCK EXCHANGE LLC
HEARING BOARD

In the Matter of NYSE Disciplinary Proceedings Against THOMAS W. HEATH, III	:	Disciplinary Proceeding No. 07-25

ORDER GRANTING DIVISION OF ENFORCEMENT'S MOTION FOR SUMMARY JUDGMENT AND DENYING RESPONDENT'S MOTION FOR SUMMARY JUDGMENT

The parties in this matter each filed a motion for summary judgment. The Division of Enforcement ("Enforcement") of NYSE Regulation, Inc. ("NYSE") filed its motion on October 18, 2006 ("Enforcement's Motion"); Respondent submitted his opposition to

Enforcement's Motion on November 9, 2006 ("Respondent's Opposition"); and Enforcement filed a reply in further support of its motion on November 16, 2006. Respondent, in turn, filed his motion for summary judgment on October 26, 2006 ("Respondent's Motion"); Enforcement filed its opposition to his motion on November 8, 2006; and Respondent filed a reply in further support of his motion on November 16, 2006.

After consideration of all of the aforementioned pleadings and their respective attachments, I have determined to grant Enforcement's Motion and to deny Respondent's Motion for the reasons set forth herein.

Legal Standard for Granting Summary Judgment

NYSE Rule 476(c), as amended effective April 1, 2006, grants a Hearing Officer the authority to "resolve any and all procedural and evidentiary matters and substantive legal motions." This includes the authority to consider and, if warranted, grant a motion for summary judgment.

NYSE Rule 476(c) is silent with respect to the legal standard to be applied in deciding a summary judgment motion under the Rule. While the Federal Rules of Civil Procedure are not applicable to NYSE proceedings per se, those rules and the case law applying them can provide helpful guidance. Moreover, the procedural rules of other regulators, such as the U.S. Securities and Exchange Commission

("SEC") and the NASD, may be taken into account, particularly since the legal standard for summary judgment that applies in both SEC and NASD proceedings is similar to the standard applied under Rule 56 of the Federal Rules of Civil Procedure. See, e.g., Edward Becker, Release No. ID-252, 82 S.E.C. Docket 3427, 2004 WL 1238256, at *2 (June 3, 2004) (analogizing to Rule 56 in applying Rule 250(a) of SEC's Rules of Practice, which governs summary judgment); Lorsin, Inc., Release No. ID-250, 82 S.E.C. Docket 3044, 2004 WL 1064141, at *2 (May 11, 2004) (same); Dep't of Enforcement v. U.S. Rica Fin., Inc., Compl. No. C01000003, 2003 WL 22149390, at *4 (N.A.S.D. N.A.C. Sept. 9, 2003) (in deciding motion for summary disposition under NASD Rule 9264, noting that "federal law also provides significant guidance").

Under Rule 56 of the Federal Rules of Civil Procedure, summary judgment is appropriate "if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." Fed. R. Civ. P. 56(c). In assessing the record for purposes of deciding a summary judgment motion, the facts, as well as the reasonable inferences that may be drawn from them, must be viewed in the light most favorable to the non-moving party. See Eastman Kodak Co. v. Image Tech. Servs., Inc., 504 U.S. 451, 456 (1992); O'Shea v.

Yellow Tech. Servs., Inc., 185 F.3d 1093, 1096 (10th Cir. 1999).

A Hearing Officer's power to decide a summary judgment motion under NYSE Rule 476(c) is analogous to that of a federal court deciding a summary judgment motion under Rule 56. Thus, under NYSE Rule 476(c), a moving party is entitled to summary judgment if it can demonstrate that there are no genuine issues of material fact and that the moving party is entitled to judgment as a matter of law. In deciding the Motion, I must take the pleadings of Respondent, the non-moving party, as true, except as modified by stipulations or admissions made by Respondent, by uncontested affidavits, or by facts of which I may take official notice. See 17 C.F.R. § 201.250(a); NASD Rule 9264(e).

Record on Summary Judgment

Respondent was employed in the Financial Institutions Group at J.P. Morgan Securities ("Morgan") from 1992 to 2005. Respondent's Motion at 5. At Morgan, Respondent had cultivated a relationship with Bank A, which allowed him to facilitate the hiring of Morgan by Bank A as its financial advisor in a merger with Bank B in February 2005. Id. at 6.

In January 2005, Respondent received an unsolicited call from AU, Global Head of Bank C's Financial Institutions Group to discuss the possibility of Respondent's joining Bank C. Id. After a subsequent meeting, Respondent told AU that Respondent

believed that it would not work out. Id. However, in February 2005, Respondent accepted a more specific offer to join Bank C as head of its bank group in exchange for compensation amounting to approximately $3 million per year for the first two years. Id. at 6-7.

At AU's behest, during the afternoon of March 1, 2005, Respondent had a telephone conversation with EC, head of Bank C's depository institutions group. Id. at 8-9.

According to Respondent, the purpose of the conversation was to demonstrate to EC that Respondent "was a 'decent guy' and a 'good partner'" who was not going to stomp all over him." Id. at 8-9 (citing Transcript of Respondent's On-the-Record Testimony to Enforcement ("Heath Tr.") at 62.) During the conversation, Respondent disclosed to EC nonpublic information concerning the acquisition that he was in the process of finalizing at Morgan, including: (1) the identity of the acquirer (Bank B) and the target (Bank A); (2) the fact that Respondent's firm was representing Bank A in the deal; (3) Bank A's belief that Bank B's price-to-earnings ratio was at such a low that it gave Bank A a "degree of comfort with the stock;" and (4) the fact that the deal was 45% cash. Heath Tr. at 66-67.

Respondent Engaged in Unethical Conduct, Even if He Did So without Bad Faith

"Unethical" Conduct Is Not Synonymous with, But Rather, Is Broader than "Bad Faith"

Respondent's main argument in support of his Motion and in opposition to Enforcement's Motion is that: (1) to prevail on its charge that Respondent violated NYSE Rule 476(a)(6), Enforcement must show that Respondent acted in bad faith; and (2) the record evidence establishes that Respondent never acted in bad faith. Respondent's Motion at 14-16; Respondent's Opposition at 2, 5-9.

Respondent, however, has not correctly characterized the state of the law. A violation of the just and equitable principles of trade codified by NYSE Rule 476(a)(6) may occur either through bad faith or unethical conduct. In the matter of Calvin David Fox, the U.S. Securities and Exchange Commission (the "SEC") stated that:

> With respect to a charge that conduct was inconsistent with just and equitable principles of trade, we have held that a self-regulatory organization need not find that the respondent acted with scienter, but must find that the respondent acted in bad faith or unethically.

Calvin David Fox, Exchange Act Release 34-48,731, 81 S.E.C. Docket 1511, 2003 WL 22467374, at *3 (Oct. 31, 2003) (emphasis added).

Respondent argues that the use of the disjunctive indicates that acting in "bad faith" and acting "unethically" are synonymous. Respondent's Opposition at 7. This interpretation is at odds with one of the most basic rules of legal interpretation—that "terms connected by a disjunctive be given separate meanings, unless the context dictates otherwise. . . ." Reiter v. Sonotone Corp., 442 U.S. 330, 339 (1979); see also United States v. Urban, 140 F.3d 229, 232 (3d Cir. 1998) (same). The holding in Fox, as well as in other SEC decisions that use the disjunctive form, see, e.g., Robert E. Kauffman, Exchange Act Release No. 34-33,219, 55 S.E.C. Docket 1287, 1993 WL 483323, at *2 n.5 (Nov. 18, 1993), Robert J. Jautz, Exchange Act Release No. 34-24,346, 38 S.E.C. Docket 91, 1987 SEC 757991, at *2 (Apr. 15, 1987), suggests that the concept of unethical conduct is different from—namely, that it is broader than—bad faith.

Nothing in the Fox decision suggests that the plain meaning of the word "or"—implying a distinction between bad faith and unethical conduct—should not be applied in interpreting that holding. This conclusion is consistent with a previous SEC holding that the rule regarding just and equitable principles of trade "is not limited to rules of legal conduct, but incorporates broad ethical principles." Peter Martin Toczek, Exchange Act Release No. 34-33,176, 55

S.E.C. Docket 1126, 1993 WL 468656, at *5 n. 14 (Nov. 9, 1993) (internal quotation marks omitted).[1]

In at least one prior hearing panel decision, the panel implicitly adopted this interpretation of unethical conduct as something broader than bad faith. See Robert Cutter Matlock, Jr., Decision 06-19 (NYSE Hearing Board Mar. 27, 2006) (holding that improper motive was not necessary to establish violation of just and equitable principles of trade). In Matlock, the issue was whether the respondent had violated NYSE Rules 476(a)(6) and 401 by bunching together customer orders—in some cases, with orders for his

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[1] Respondent cites the SEC's holding in Nicholas T. Avello, Exchange Act Release No. 34-51,633, 2005 WL 1006827 (Apr. 29, 2005), aff'd 454 F.3d 619 (7th Cir. 2006), as support for his argument that nothing less than a showing of bad faith will suffice to prove a violation of the just and equitable principles of trade. In that case, the SEC held—and the Court of Appeals agreed—that no showing of bad faith is required when the violation of the just and equitable principles of trade is predicated on a violation of some other law or regulation. See Avello, 2005 WL 1006827, at *3; 454 F.3d at 627. Since both the SEC and the Court of Appeals found that the respondent in Avello did commit violations of rules other than the NASD's rule on just and equitable principles of trade, any suggestion by the SEC or the Court of Appeals in their respective decisions that actual bad faith—as opposed to some broader concept of unethical conduct—is required to show a violation of just and equitable principles of trade, in the absence of a violation of another rule, is mere dictum. Given the repeated use of the disjunctive form by the SEC over the years, if the SEC were going to reverse itself on this issue, one would have expected a more lengthy and reasoned discussion than the one-sentence dictum in Avello.

personal account—and then allocating the trades, post-execution, to various accounts, at prices that he set arbitrarily. The evidence did not establish that the respondent had personally benefited from these actions or that he passed along a price advantage to any particular customer. Nevertheless, that panel held:

> The Panel does not need to find that Respondent actually granted anyone preferential treatment—or, indeed, intended to do so. Rather, the fact that Respondent improperly gave himself the ability to convey an advantage on himself or any particular customer is sufficient to support a finding that he breached his ethical duties under Rules 401(a) and 476(a)(6).

Matlock, at 9 (citing Keith Springer, Exchange Act Release No. 34-45,439, 76 S.E.C. Docket 2189, 2002 WL 220611, at *7 (Feb. 13, 2002) (finding violation of NYSE Rules 401 and 476(a)(6) for improper post-execution allocation of trades, regardless of whether respondent had improper intention or motive)).

I find that conduct may be inconsistent with the just and equitable principles of trade in the absence of bad faith, if such conduct is unethical, and I, therefore, must deny Respondent's Motion.

By Disclosing Confidential Information, Respondent Acted Unethically

A. A Financial Advisor Owes A Duty of Confidentiality to His Client

There is no dispute that the information that Respondent disclosed to EC included sensitive, nonpublic details of a transaction that had not yet been consummated, including the identity of the acquirer and target, the fact that Respondent's firm was representing the target, information about his client's belief that the acquirer's price-to-earnings ratio was at such a low that it gave his client a "degree of comfort with the stock," and the fact that the deal was 45% cash. Heath Tr. at 66-67. It is commonly accepted that when a financial advisor takes on work that requires the communication of such sensitive, nonpublic information from the client to the advisor, the client has an expectation that the advisor will keep that information confidential. See Frank J. Furino, Decision 05-113, at 3 (NYSE Hearing Board Sept. 30, 2005). When receiving confidential information from a client, the advisor makes an implicit promise—and, therefore, takes on a corresponding duty—to safeguard the confidentiality of that information.

It is undisputed that Respondent's employer had a Code of Conduct that spelled out the duties of an employee to keep confidential certain sensitive information learned on the job. See Respondent's Opposition at 12. But the duty of confidentiality at issue here stems not only from the explicit Code of

Conduct, but also from the ethical obligation to which every financial advisor becomes subject upon learning of sensitive, nonpublic information about a client in the normal course of business. It is a duty that should be self-evident to any experienced financial professional.[2]

By disclosing confidential information about the pending transaction to someone who, at the time of the disclosure, was an employee of a competitor firm, Respondent breached the duty that he owed to his client and thereby violated the just and equitable principles of trade.[3]

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[2] Respondent implicitly acknowledges this uncontroversial principle when he argues that the pledge of confidentiality that he received from EC was "made by one experienced banker to another, made by someone who understood the implications of his promise, and who knew, or should have known, that the ethical standards of the industry and his company required that he maintain [Respondent's] confidence." Respondent's Motion at 15. By the same token, Respondent himself, as an experienced banker, should have known that "the ethical standards of the industry and his company required that he maintain" his client's confidence in the first place. See id; see also Ralph Joseph Presutti, Exchange Act Release No. 34-37,351, 62 S.E.C. Docket 528, 1996 WL 384596, at *3 n.14 (June 24, 1996) (noting that "experienced representative" is charged with knowledge of "ethical standard" that governs his or her conduct).

[3] In support of his Motion and in opposition to Enforcement's Motion, Respondent submitted a letter from a senior executive of his former client, in which the latter stated that he did not view Respondent's "discussion as a breach of our confidence." of 2/10/06 (Respondent's Motion Ex. 1). However, that letter was prepared and submitted long after the breach

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B. There Was No Competing Obligation or "Equitable Excuse" to Justify Respondent's Action

Respondent contends that SEC precedent supports a finding that, because Respondent acted without bad faith, he cannot be found liable of a violation of the just and equitable principles of trade. However, one of the seminal cases to which Respondent cites—Buchman v. SEC, 553 F.2d 816 (2d Cir. 1977)—is clearly distinguishable because it involved a competing regulatory obligation that justified the respondent's actions and exonerated him from a finding that he had violated the just and equitable principles of trade.

In Buchman, the Second Circuit vacated the SEC's finding that the respondent-broker-dealer had violated the NASD's "just and equitable principles" rule for refusing to complete certain stock transactions. The court noted that the broker-dealer's refusal to consummate the trades came during and after actions by the SEC to suspend trading in the subject stock, including a release issued seven months after the initial suspension, notifying broker-dealers that "there was a real possibility of a spill-over of the

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occurred and apparently in the executive's personal capacity, rather than on behalf of the client. In the absence of any contemporaneous waiver by his client, Respondent's obligation to maintain the confidentiality of his client's information is unaffected.

unlawful activity to open contracts." Id. at 818, 821. On these facts, the court held that:

> [T]here can be no doubt of appellants' bona fide belief "that there was a manipulative scheme afoot" and that, based upon the warning issued by the Commission after the suspension was lifted, the manipulative scheme still affected open contracts. This record does not support a conclusion that appellants were snatching excuses out of thin air. They were bound to cooperate with the Commission in refusing to accept stock which would succeed in bringing the fruits of manipulation to a guilty seller."

Buchman, 553 F.2d at 821 (emphasis added). In other words, it was not the mere fact that the accused had acted in good faith; it was the fact that he had acted in accordance with a competing legal and ethical obligation to cooperate with the SEC in its efforts to counteract manipulative practices in the market.

As the SEC has put it, "To come within the . . . Rule on [just and equitable principles of trade] it should appear that the breach was committed without equitable excuse or justification." Lerner & Co., Exchange Act Release No. 34-5,538, 1957 WL 52425, at *4 (June 28, 1957) (finding that respondent's refusal to accept delivery and pay for shares did not constitute unethical conduct because counterparty had failed to procure and vote proxies as promised, thereby relieving respondent of both its legal and moral obligation to accept undelivered shares).

Accord Morris E. Kurz, Exchange Act Release No. 34-33,764, 56 S.E.C. Docket 676, 1994 WL 91259 (Mar. 15, 1994) (respondent did not engage in conduct inconsistent with just and equitable principles of trade by failing to forward commissions to his firm as required by his employment contract, because his firm had previously committed material breaches of that contract, thereby relieving respondent of his obligations to share commissions); Southern Brokerage Co., Inc., Exchange Act release No. 34-7,463, 1964 WL 66923, at *4 (Nov. 19, 1964) (respondent's refusal to consummate stock transaction did not constitute unethical or dishonorable conduct where its decision was based on information, including pending SEC investigation, which indicated that counterparty was involved in "fraudulent activities").

Nothing in the record would indicate that Respondent, in the instant matter, was under any competing obligation to make the disclosures that he did or that any "equitable excuse" relieved him of his ethical obligation to keep the information confidential. Rather, his reasons for making the disclosures—while certainly lacking any malevolent or deceitful quality—were, in the final analysis, self-serving in that they were intended to gain the trust of, and thereby smooth things over with, a soon-to-be colleague. Respondent admits that he made the disclosures, at least in part, to make EC "understand that he was going to be a good partner and that he

was not going to 'stomp all over him.'" Respondent's Motion at 16.[4] On the record before me, I cannot find anything that excuses the unethical conduct in which Respondent engaged.

C. The Protection of Confidential Information Is Important to Avoid Potential Harm to the Market

Finally, Respondent argues that I should not grant summary judgment to Enforcement on the charge of conduct inconsistent with just and equitable principles of trade because neither his former firm nor his former client "were injured in any way as a

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[4] Respondent's claim that he also made the disclosures to preempt EC from "'snoop[ing] around' the deal" and "dissuade him from acting on information in the market place," Respondent's Motion at 16, does not change my holding. Even assuming it were true, as I must for purposes of deciding Enforcement's Motion, I do not find that this concern rises to the level of a competing obligation or "equitable excuse" that absolves Respondent of his breach of confidentiality. On the contrary, if Respondent suspected that EC might "snoop around the deal" for the purposes of "acting on information in the market place," Respondent could have—and, indeed, should have—taken other steps to prevent such a result, such as alerting his current and future employers, as well as his client, to his suspicions. If anything, those suspicions regarding EC should have made Respondent even more reluctant to divulge sensitive information to his would-be colleague and, thus, only served to heighten Respondent's ethical obligation to safeguard his client's confidential information against incursion by this potentially untrustworthy individual.

result of the disclosure." Respondent's Opposition at 13.

Respondent's argument misses the point of NYSE Rule 476(a)(6). First, to find a violation of the Rule, I need not find that any harm was actually suffered. See, e.g., Matlock (finding violation of NYSE Rule 476(a)(6) even in absence of evidence that Respondent or anyone else improperly benefited from his post-execution allocation of trades).[5] Second, the Rule must be applied to prevent conduct that has the mere potential of causing harm, whether or not harm actually occurs in any given case, if the NYSE is to achieve its policy mandate, as set forth in Section 15A(b)(6) of the Securities Exchange Act of 1934, which includes the need:

> [T]o prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and

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[5] The alleged absence of actual harm is, however, a legitimate factor for consideration at the penalty phase. See McCarthy v. SEC, 406 F.3d 179, 190 (2d Cir. 2005) ("the corresponding harm to the trading public" is one of several "relevant factors to be considered in deciding whether the sanction is appropriately remedial and not excessive and punitive"). See also Factors Considered by the New York Stock Exchange Division of Enforcement in Determining Sanctions, Information Memo. 05-77, at 2 (Oct. 7, 2005) (factors considered in determining sanctions should include "harm caused by the violation").

> facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest. . . .

15 U.S.C.A. § 78o-3(b)(6).

There can be no question that the disclosures that Respondent made did have the potential for unraveling the deal. Had that occurred, many investors could have been harmed—not merely Respondent's client or his firm, but also the shareholders of those organizations.

In addition, a finding here that Respondent's disclosure does not constitute a violation of the just and equitable principles of trade has the potential to do even greater harm to the market because of the message that it would send to the financial community. What Respondent did in this case was effectively an unauthorized and selective disclosure of material, nonpublic information. Regulation Fair Disclosure or "Reg FD," which Respondent himself cites to, see Respondent's Opposition at 10,[6] was adopted precisely

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[6] Respondent cites Reg FD, 17 C.F.R. § 243.100(b)(2), to support his contention that, "under the federal securities laws the disclosure of confidential information, pursuant to an express agreement of confidentiality, is explicitly permitted." Respondent's Opposition at 10. Without holding that Reg FD applies directly to the situation in this case, it should be noted that, as the SEC explained in its 2000 release on Reg FD, the exclusions set forth in paragraph (b)(2) embody an "approach [that] recognizes that issuers and their officials may properly

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to address the concern about the "adverse impact on market integrity" from selective disclosures. See Selective Disclosure and Insider Trading, Exchange Act Release No. 34-43,154, 73 S.E.C. Docket 3, 2000 WL 1201556, at *2 (Aug. 15, 2000). If the NYSE Rules do not punish the disclosure of material, nonpublic information about a client's financial affairs by an investment banker to an employee of a rival investment bank—particularly in the absence of any formal legal remedies—there is a similar risk to the integrity of future transactions and, therefore, to the market in general. It is a risk that we cannot afford.

For these reasons, I have determined to grant Enforcement's Motion and deny Respondent's Motion.

Accordingly, Respondent is found guilty of Charge I of the Charge Memorandum, and the hearing currently scheduled to begin at 10:00 AM on December 11, 2006 shall be a hearing on the appropriate penalty to be imposed.

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share material nonpublic information with outsiders, for legitimate business purposes, when the outsiders are subject to duties of confidentiality." Selective Disclosure and Insider Trading, Exchange Act Release No. 34-43,154, 73 S.E.C. Docket 3, 2000 WL 1201556, at *8 (Aug. 15, 2000) (emphasis added). Respondent's own admissions suggest that, far from acting to achieve a "legitimate business purpose" of his client, Respondent made the disclosures at issue for personal reasons. See, e.g., Respondent's Motion at 16.

SO ORDERED

Dated: November 24, 2006

Peggy Kuo
Chief Hearing Officer

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